FEDERAL TRADE COMMISSION DECISIONS

FINDINGS, OPINIONS AND ORDERS

JANUARY 1, 1985 TO JUNE 30, 1985

PUBLISHED BY THE COMMISSION

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MEMBERS OF THE FEDERAL TRADE COMMISSION

DURING THE PERIOD JANUARY 1, 1985 TO JUNE 30, 1985

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Took oath of office September 30, 1981

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Took oath of office October 29, 1979

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Took oath of office December 27, 1982

TERRY CALVANI, *Commissioner*
Took oath of office November 18, 1983

MARY L. AZCUENAGA, *Commissioner*
Took oath of office November 27, 1984.

EMILY H. ROCK, *Secretary*
Appointed April 17, 1983

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FEDERAL TRADE COMMISSION DECISIONS

Findings, Opinions and Orders

IN THE MATTER OF

THE CITY OF NEW ORLEANS

ORDER IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket 9179. Complaint, May 10, 1984—Order, Jan. 3, 1985

This Order withdraws the Commission Complaint alleging that the City of New Orleans violated Sec. 5 of the FTCA by conspiring with taxicab operators to increase fares and limit the number of taxicab licenses, with the effect of eliminating competition. Following enactment of legislation by the State of Louisiana which provided that "[T]he policy of this state is to require that municipalities . . . regulate [taxicabs] and not to subject municipalities or municipal officers to liability under federal antitrust laws" and which specifically empowers cities to regulate entry and control fares for taxicabs, the Commission determined that continuing this matter would not presently serve the public interest.

COMPLAINT

The Federal Trade Commission, having reason to believe that The City of New Orleans, a municipal corporation subject to the jurisdiction of the Commission, hereinafter sometimes referred to as Respondent or the City, has violated the provisions of the Federal Trade Commission Act, as amended (15 U.S.C. 45), and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges as follows:

For purposes of this complaint, the following definitions shall apply:

(A) *Taxicab* means a motor vehicle that is duly licensed to be operated as a taxicab by the City, that has a normal seating capacity of less than ten (10) passengers, and that is used for the transportation of passengers for hire primarily over streets of New Orleans by a route or to a destination controlled by the passenger(s).

(B) *CPNC* means a certificate of public necessity and convenience issued by the Director of the Department of Utilities of the City pursuant to the requirements of Section 12-4 of Chapter 12 of the

Code of the City of New Orleans permitting an individual or company to operate a taxicab in New Orleans.

(C) *Taxicab company* means any business organization, corporation, partnership, cooperative or person that as of the date of this complaint has a trade name and color scheme registered with the Taxicab and For Hire Vehicle Bureau as specified by Section 12–162 of Chapter 12 of the Code of the City of New Orleans for the purpose of operating taxicabs or providing services related to the business of owning, operating and/or driving taxicabs to taxicab owners, operators and/or drivers authorized to do business by the City.

PARAGRAPH 1. Respondent is a municipal corporation organized under the laws of the State of Louisiana and is a person or corporation within the meaning of the Federal Trade Commission Act, as amended (15 U.S.C. 45). The City has passed and enforces certain ordinances that regulate the taxicab business in New Orleans.

PAR. 2. At all times relevant herein, Respondent's acts and practices have affected the businesses of taxicab companies and taxical owners, operators and/or drivers that maintain, and have maintained, substantial courses of business, including the acts and practices as hereinafter set forth, which are in or affect commerce, a "commerce" is defined in the Federal Trade Commission Act, a amended, and Respondent is subject to the jurisdiction of the Federa Trade Commission. The acts and practices alleged herein are in o affect commerce by affecting at least the following activities that ar in or affect commerce:

(A) Taxicabs and taxicab companies provide a primary method c transportation for interstate travelers between New Orleans International Airport and destinations in New Orleans.

(B) Taxicabs and taxicab companies provide transportation for interstate travelers between New Orleans and nearby cities in Mississippi.

(C) Taxicabs and taxicab companies provide transportation to inte state travelers between train stations, bus terminals and ports an other destinations in New Orleans.

(D) Taxicabs and taxicab companies provide transportation to inte state travelers between hotels, motels, convention centers, and touri attractions and other destinations in New Orleans.

(E) Taxicabs are manufactured in other states and are transporte into and sold in Louisiana.

(F) Items and services purchased in substantial quantities such a gasoline, tires, taximeters, two-way radios and various replacemen parts for taxicabs originate in other states and are sold for use in ar transported into Louisiana.

(G) Employment opportunities as a New Orleans taxicab driver have attracted persons from other states.

PAR. 3. For many years and continuing up to and including the date of the issuance of this complaint, the City has combined, contracted or agreed with taxicab companies, to pursue the following policies and do the following acts, among others:

(A) To encourage taxicab companies to combine and to agree upon proposals to increase fares for taxicabs in New Orleans.

(B) To adopt uniform fares applicable to all taxicabs upon request by taxicab companies.

(C) To limit the number of CPNC's in New Orleans and to prohibit by other means, new entry of taxicab drivers, owners and operators into New Orleans.

(D) To raise unreasonable barriers to entry to new taxicab companies in New Orleans.

(E) To prohibit competition from vehicles-for-hire licensed outside New Orleans.

PAR. 4. The acts and practices of respondent, as alleged in Paragraph Three, have been and are now having the effects, among others, of:

(A) eliminating and preventing substantial competition between competitors and potential competitors in the operation of taxicabs in New Orleans;

(B) strengthening the market power of currently authorized taxicab companies operating in New Orleans taxicab market;

(C) raising, fixing, stabilizing, maintaining, or otherwise interfering or tampering with the rates charged for taxicab service in and from New Orleans; and

(D) depriving interstate and intrastate consumers of taxicab services in and from New Orleans of the benefits of free and open competition in taxicab services.

PAR. 5. The acts and practices of Respondent, as alleged herein, were and are to the prejudice and injury of the public and constituted and constitute unfair methods of competition in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, as amended. The acts and practices, as herein alleged, are continuing and will continue in the absence of the relief herein requested.

STATEMENT OF CHAIRMAN JAMES C. MILLER III

After extensive consideration of the issue, I have voted today to issue complaints in accordance with my statutory responsibility to act when there is reason to believe that the law has been violated.

The action taken by the Commission today is based upon allegations of monopoly power and alleged violations of the U.S. antitrust laws in the taxi markets of Minneapolis [105 F.T.C. 304] and New Orleans. As a technical matter, the way a case is brought most effectively in such situations is to address regulations enacted by the city governments. I wish to stress that our concern is with allegations of monopoly power in taxi markets, and is not driven by any interest in limiting the lawfully-exercised powers of the cities themselves.

I also wish to stress that our concern is solely with restraints on *competition;* we have no concerns with rules affecting safety, insurance, and other related service standards.

The Commission's decision today comes after a 10-year staff study of taxi markets, after extensive inquires and discussions with city officials and taxi operators, and after thorough briefing of the Commission by the agency's career staff.

STATEMENT OF COMMISSIONER MICHAEL PERTSCHUK* DISSENTING FROM THE ISSUANCE OF COMPLAINTS AGAINST THE CITIES OF MINNEAPOLIS AND NEW ORLEANS

I dissent from the Commission's decision to issue complaints against the cities of Minneapolis [105 F.T.C. 304] and New Orleans charging each city with an illegal combination or conspiracy in violation of the Sherman and FTC Acts. The complaints allege that each city conspired with taxicab owners and drivers to restrain trade in the provision of taxicab services through the enactment of municipal regulations that establish fixed taxi fares and create barriers to entry into the market.

For the Commission to succeed under the theories alleged in these complaints, it must first prove that the challenged regulations were the result of an illegal combination or conspiracy rather than lawful actions taken by the cities in the interest of their citizens. I am troubled by the idea that a city's adoption of taxi regulations after consultation with the industry—when consultation is a necessary element of responsible government—transforms the city's regulations into an illegal conspiracy.

Second, when the federal antitrust laws come in apparent conflict with regulations enacted by a governmental entity such as a municipality, the Commission must be especially confident that federal intervention is warranted. Here it is at the very least unclear whether the economic theory of these complaints fits the facts as we know them. Studies commissioned by the Department of Transportation and others of cities where taxi service was deregulated do not demonstrate that the public benefited. Fares often rose and there is considerable doubt whether service improved. Finally, Congress is currently considering legislation which would exempt most municipal regulations from antitrust scrutiny. I note that the Assistant Attorney General in charge of the Antitrust Division has recently testified in support of that legislation. While the Commission need not consider pending legislation when deciding whether to act, the unpredictable effects of the Commission's action on the taxi market and the legitimate regulatory interests of the cities counsel restraint in these cases.

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* Michael Pertschuk, Commissioner 1977–1984.

ORDER

Complaint counsel have moved for withdrawal of the complaint in this matter, on the ground that state legislation enacted after the complaint was issued makes effective relief impossible. The Administrative Law Judge has certified that motion to the Commission. The complaint alleges that the City of New Orleans has combined, contracted or agreed with taxicab companies in a number of respects relating to fare increases, fare uniformity, limitations on the number of certificates of public necessity and convenience issued, and barriers to entry, in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45.

After the complaint was issued, the State of Louisiana enacted a statute that provides:

> [T]he policy of this state is to require that municipalities . . . regulate [taxicabs] and not to subject municipalities or municipal officers to liability under federal antitrust laws.[1]

The statute also specifically empowers cities to regulate entry and control fares for taxicabs.[2] After careful consideration, the Commission has determined that continuing this matter would not presently serve the public interest.[3] We have therefore concluded that the complaint in this matter should be withdrawn. In taking this action, we express no opinion as to whether the liability of the City of New Orleans could have been established at trial, or whether an independent judicial proceeding might establish that federal statutes embodying the national policy of competition preémpt the new Louisiana statute. We also express no opinion as to the merits of the complaint issued against the City of Minneapolis in Docket No. 9180.

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[1] Act of June 6, 1984, NO. 518 (to be codified at LA. REV. STAT. ANN. Section 33:4792 A(e)).

[2] *Id.* Sections B(1), (2).

[3] *See Community Communications Co.* v. *City of Boulder,* 455 U.S. 40, 55–56 (1982); *California Retail Liquor Dealers Association* v. *Midcal Aluminum, Inc.,* 445 U.S. 97, 105 (1980); *New Motor Vehicle Board of California* v. *Orrin W. Fox Co.,* 439 U.S. 96, 109 (1978); *City of Lafayette* v. *Louisiana Power & Light Co.,* 435 U.S. 389, 410 (1978).

Accordingly, *it is ordered*, that the complaint issued against the City of New Orleans in Docket No. 9179 be, and it hereby is, withdrawn.

IN THE MATTER OF

SOUTHWEST SUNSITES, INC., ET AL.

FINAL ORDER, OPINION, ETC. IN REGARD TO ALLEGED VIOLATIONS OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket 9134. Complaint, April 29, 1980—Final Order, Jan. 15, 1985

This order requires four companies and three individuals engaged in the advertising and sale of undeveloped land, among other things, to cease representing misleadingly or without proper substantiation that the purchase of any land is a sound financial investment; involves little or no monetary risk; and will benefit the purchaser economically as a result of profitable resale, mineral rights, exploration or extraction. The firms are prohibited from representing that any land is currently usable as a homesite, farm or ranch, unless that land can be used immediately for the represented purpose without any substantial improvement or development by the purchaser; and barred from misrepresenting the availability or cost of obtaining electric power, potable water, telephone service or sewage disposal. The order further requires that the firms prepare and furnish consumers with a fact sheet containing detailed information regarding the availability and cost of water, electric power, sewer disposal and telephone service, unless a federal property report accompanying sale transactions includes such information. The companies must also insert in advertisements, promotional material and sales presentations specified statements warning that investment in land is risky and prospective purchasers should consult a qualified professional before buying. Such warnings must also be included in contracts, as well as a clause giving purchasers seven days in which to cancel their transactions. Additionally, the firms are required to provide consumers with cancellation forms; honor all valid cancellation requests; and send prescribed notices to past purchasers advising them of the Commission's order; explaining the land's actual value and suitability for use, and outlining the alternative options available to these consumers. The order further requires that the companies provide their sales representatives with a copy of the order; institute a surveillance program designed to reveal those that fail to comply with the terms of the order; and maintain certain records for a specified period of time.

Appearances

For the Commission: *Gary D. Kennedy.*

For the respondent: *Glenn A. Mitchell* and *David U. Fierst, Stein, Mitchell & Mezines,* Washington, D.C.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, as amended, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Southwest Sunsites, Inc., Green Valley Acres, Inc., and Green Valley Acres, Inc. II, corporations; Sydney Gross and Edwin Kritzler, individually and as officers or former officers of said corporations; Porter Realty, Inc., a corporation; and Irvin Porter, individually and as an officer or former officer of said corporation, hereinafter sometimes collectively referred to as respondents, have violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges with respect thereto as follows:

PARAGRAPH 1. Respondents Southwest Sunsites, Inc., Green Valley Acres, Inc., and Green Valley Acres, Inc. II, hereinafter sometimes referred to as "corporate subdivider respondents," are corporations organized, existing and doing business under and by virtue of the laws of the State of Texas, with their offices and principal places of business located at 16000 Ventura Boulevard, Encino, California.

Respondents Sydney Gross and Edwin Kritzler are officers or former officers of some or all of the corporate subdivider respondents. They formulate, direct and control, and for some time last past have formulated, directed and controlled, [2] the acts and practices of the corporate subdivider respondents, including the acts and practices hereinafter set forth. Their address is the same as that of the corporate subdivider respondents. Corporate subdivider respondents and respondents Gross and Kritzler are sometimes hereinafter referred to collectively as "subdivider respondents."

PAR. 2. Respondent Porter Realty, Inc., hereinafter sometimes referred to as "corporate broker respondent," is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Florida, with its office and principal place of business located at 717 Ponce de Leon Boulevard, Coral Gables, Florida.

Respondent Irvin Porter is an officer or former officer of the corporate broker respondent. He formulates, directs, and controls, and for some time last past has formulated, directed and controlled, the acts and practices of the corporate broker respondent, including the acts and practices hereinafter set forth. His address is the same as that of the corporate broker respondent. Corporate broker respondent and respondent Irvin Porter are sometimes hereinafter referred to collectively as "broker respondents."

PAR. 3. All respondents mentioned herein cooperate and act together in carrying out the acts and practices hereinafter set forth.

PAR. 4. Subdivider respondents are now, and for some times last past have been, engaged in the business of acquiring undeveloped land, subdividing said land into five acre, ten acre and forty acre lots and advertising, offering for sale and selling said lots to the public, directly and through the use of agents, brokers and others. Among the properties offered for sale and sold are Sunsites Ranch Unit I and Sunsites Ranch Unit II of Southwest Sunsites, Green Valley Acres and Green Valley Acres II, all located in Culberson or Jeff Davis Counties, Texas. The acreage of these properties, hereinafter sometimes referred to as "the subdivisions," is approximately forty thousand (40,000) acres.

PAR. 5. Subdivider respondents sell lots in the subdivisions to purchasers by use of standard form contracts whereby the purchaser agrees to pay monthly installments over terms ranging up to ten years. According to the provisions of the contract, title to the lots is retained by the subdivider respondents until the final payment is made. The contract specifies that title is to pass to the purchaser within a reasonable time after the final payment is made. Purchasers pay interest to subdivider [3] respondents during the contract term on the unpaid balance owing on the contract.

PAR. 6. Broker respondents are now, and for some time last past have been, engaged in the business of selling lots in the subdivisions to the public through telephone solicitations and direct mailings. Broker respondents have sent and are now sending through the mail brochures, fact sheets, contracts and other sales literature to potential purchasers. Signed contracts and downpayments are sent directly by purchasers to the subdivider respondents for acceptance. Broker respondents are paid by subdivider respondents a predetermined fee or commission over the course of the contract.

PAR. 7. In the course and conduct of their aforesaid businesses, respondents now cause, and for some time past have caused, their advertisements, promotional materials, contracts and various business papers to be transmitted through the U.S. mail and other interstate instrumentalities from their various places of business to agents, representatives, employees, customers and prospective customers in various other States of the United States and in foreign countries. Subdivider respondents have maintained and operated places of business in the various States of the United States and both subdivider and broker respondents have made and are now making substantial sales to purchasers in various States of the United States and in foreign countries. Respondents maintain, and at all times mentioned herein have maintained, a substantial course of trade in undeveloped land in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended.

PAR. 8. In the further course and conduct of their aforesaid businesses, subdivider respondents disseminate and have disseminated commercials through television and radio broadcasts and, both prior and subsequent to sales, subdivider respondents and broker respondents disseminate and have disseminated promotional materials through the U.S. mail and in person to members of the public, and make and have made oral sales presentations by means of telephone calls, in-home solicitations, on-site presentations and free dinner parties.

I

PAR. 9. By and through the means described in Paragraph Eight, respondents have represented and are representing, directly or by implication, that the lots which respondents are offering for sale are a good investment [4] at the price respondents are offering them for sale, and that there is little or no financial risk involved in the purchase of said lots at said prices.

PAR. 10. In truth and in fact, lots which respondents have offered and are offering for sale, at the prices respondents have offered and are offering them for sale, have not been and are not good investments involving little or no financial risk to purchasers. Therefore, the acts and practices alleged in Paragraph Nine are unfair or deceptive.

PAR. 11. In the further course and conduct of their aforesaid businesses, respondents have offered and are offering lots for sale to prospective purchasers who have beliefs, regarding the potential investment and lack of financial risk, contrary to material facts not disclosed. Such facts are that said lots, at the price respondents are offering them, are a risky investment in that, *inter alia,* the future value of the lots is uncertain and the purchaser probably will be unable to sell his lot, or his interest in the lot under the contract, at or above the purchase price. Such facts, if known by certain purchasers, would be likely to affect materially their consideration of whether to purchase a lot from respondents. The failure to disclose such facts clearly and conspicuously is an unfair or deceptive act or practice.

II

PAR. 12. In the further course and conduct of their aforesaid businesses, by and through the means described in Paragraph Eight, respondents have represented and are representing, directly or by implication, that the lots in the subdivisions are suitable for use by purchasers as homesites, farms and ranches.

PAR. 13. In truth and in fact, all or most of the lots in the subdivisions, in the size parcels in which they are sold, are not suitable for use by purchasers as homesites, farms or ranches because of, *inter alia,*

(a) the unavailability of, or high cost of obtaining, utilities, water, financing, equipment, improvements and other amenities;

(b) the failure of subdivider respondents to install promised improvements to the subdivisions; and [5]

(c) certain practices of subdivider respondents which substantially impair the ability of purchasers to live on or use their lots.

Therefore, the acts and practices alleged in Paragraph Twelve are unfair or deceptive.

Par. 14. In the further course and conduct of their aforesaid businesses, respondents have offered and are offering lots for sale to prospective purchasers who have beliefs, regarding the suitability for use of said lots as a homesite, farm or ranch, contrary to material facts not disclosed. Such facts, if known by certain purchasers, would be likely to affect materially their consideration of whether to purchase a lot from respondents. The failure to disclose such facts clearly and conspicuously is an unfair or deceptive act or practice.

III

Par. 15. In the further course and conduct of their aforesaid businesses, respondents have induced and are continuing to induce purchasers of lots in the subdivisions to make payments due on their contracts, as well as additional payments substantially in advance of their due dates as provided for in said contracts. Respondents induce such due payments and such advanced payments on subdivision lots which are of little or no value to purchasers as an investment, homesite, farm, or for any other reasonable use as described in Paragraphs Nine through Fourteen above. Such purchasers have made and are making such payments toward the purchase of lots in reliance upon the aforementioned oral and written unfair and deceptive statements, representations and practices, and pursuant to continuing efforts by respondents to induce further payments by means of collection letters, prepayment discount offers, and numerous representations, including deceptive representations, concerning or relating to the subdivisions. Pursuant to respondents' continuing inducements as set forth herein, respondents have received and are receiving substantial sums of money and have failed to offer to refund or refused to refund such money to purchasers.

Par. 16. The use by respondents of the practices described in Paragraph Fifteen and their continued retention of the monies collected, as aforesaid, are unfair acts or practices.

Par. 17. The use by respondents of the aforementioned false, misleading, unfair and deceptive statements, representations, acts and practices, directly or by implication, and the failure of respondents to disclose [6] the aforementioned material facts, has had, and now has, the capacity and tendency to mislead members of the public into the erroneous and mistaken belief that said statements and representations were, and are, true and complete, and into the purchase of substantial quantities of respondents' lots by reason of said erroneous and mistaken belief.

PAR. 18. The acts and practices of respondents, as herein alleged, were and are all to the prejudice and injury of the public and constituted, and now constitute, unfair or deceptive acts or practices in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act. The acts and practices of respondents, as herein alleged, are continuing and will continue in the absence of the relief herein requested.

INITIAL DECISION BY

THOMAS F. HOWDER, ADMINISTRATIVE LAW JUDGE

JULY 29, 1982

PRELIMINARY STATEMENT

The Commission's complaint in this matter was issued on April 29, 1980, alleging three counts of unfair or deceptive acts or practices in the sale to the public of undeveloped parcels of land in far West Texas. [2]

Three corporations and two individuals were named as "subdivider" respondents, *viz.*, Southwest Sunsites, Inc., Green Valley Acres, Inc., and Green Valley Acres, Inc. II, together with Messrs. Sidney Gross and Edwin Kritzler who were alleged to "direct and control" these corporations.

The complaint also named Mr. Irvin Porter and Porter Realty, Inc. as "broker" respondents. Prior to the hearings, the "broker" respondents and complaint counsel entered into a consent agreement, and the charges as to these respondents were not litigated.[1]

Count I charged respondents with falsely representing the land to be a good investment at the offered price, having little or no financial risk (pars. 9–10). Secondly, it alleged that respondents failed to disclose certain material facts concerning the risky nature of investing in the land by purchasers holding contrary beliefs. The undisclosed facts were identified as "*inter alia,* the future value of the lots is uncertain and the purchaser probably will be unable to sell his lot or his interest in the lot under the contract, at or above the purchase price" (par. 11).

---

[1] Accordingly, the use of the word "respondents" in this decision will normally refer only to the subdivider respondents.

Count II charged respondents with falsely representing the subdivided lots as suitable for use as homesites, farms and ranches. Factors listed as precluding such use were: (1) the unavailability or high cost of obtaining utilities, water, financing, equipment, improvements and other amenities; (2) the failure of respondents to install promised improvements; and (3) certain practices of respondents which substantially impair the ability of purchasers to live on or use their lots. Count II alleges further that respondents failed to "clearly and conspicuously" disclose material facts concerning their lots (pars. 12–14).

Count III charged respondents with unlawfully inducing purchasers to make payments on their lots, which allegedly "are of little or no value to purchasers as an investment, homesite, farm, or for any other reasonable use . . ." Such payments are alleged to be made in reliance upon the representations and practices previously described, and "pursuant to continuing efforts by respondents to induce further payments by means of collection letters, prepayment discount offers, and numerous representations, including deceptive representations, concerning [3] or relating to the subdivisions." Respondents were also charged with receiving substantial sums of money, and with failing to offer to refund or refusing to refund this money (par. 15).

The acts and practices of respondents, as set forth in the three counts of the complaint were alleged to violate Section 5 of the Federal Trade Commission Act (par. 18).

Respondents answered, admitting the nature of their business and certain corporate data, but essentially denying all charges.

Prehearing conferences were held in Washington, D.C. on July 7, 1980, August 8, 1980 and January 16, 1981. Adjudicative hearings commenced in Dallas, Texas on April 13, 1981 and continued from time to time in that city and in Van Horn, Texas and in Albuquerque, New Mexico until completion of the case-in-chief and the defense in November, 1981. A brief rebuttle hearing was held in Washington, D.C. in January, 1982.

The record was closed for the reception of evidence on February 9, 1982, following the various record-correction activities of the parties. Extensive proposed findings were submitted, the final submission occurring on March 26, 1982.

Any motions not previously specifically ruled upon, either directly or by the necessary effect of the conclusions in this decision, are hereby denied.

This proceeding is before me upon the complaint, answer, testimony and other evidence, and the proposed findings of fact and conclusions of law filed by counsel. The proposed findings of fact, conclusions and arguments of the parties have been considered, and those findings not adopted either in the form proposed or in substance are rejected as not supported by the evidence or as involving immaterial issues not necessary for this decision.

Certain abbreviations, such as the following, are used in this decision:

CX - Commission's exhibit.
CPF - Complaint counsel's proposed finding.
RX - Respondent's exhibit.
RPF - Respondent's proposed finding.

The transcript of testimony is usually referred to with the last name of the witness and the page number or numbers upon which the testimony appears. [4]

Having heard and observed the witnesses, and after having reviewed the entire record in this proceeding, I make the following findings:

FINDINGS OF FACT

I. THE RESPONDENTS

1. Respondent Southwest Sunsites, Inc. ("SWS") is a corporation organized, existing and doing business under and by virtue of the laws of the State of Texas. Its office and principal place of business is located at 16000 Ventura Boulevard, Encino, California. (complaint par. 1; answer, par. 1).

2. SWS was incorporated on February 26, 1973 under the name Southwest Land Sites, Inc. The name was changed to SWS on November 5, 1973, by amendment to the articles of incorporation (CX 1B, D).

3. Respondents Green Valley Acres, Inc. ("GVA") and Green Valley Acres, Inc. II ("GVA II") are likewise Texas corporations, with their offices located at 16000 Ventura Boulevard, Encino, California. GVA was incorporated on March 11, 1976 and GVA II was incorporated on May 9, 1977 (complaint, par. 1; answer, par. 1; CX 14B; CX 23B).

4. The business engaged in by SWS, GVA and GVA II is that of acquiring undeveloped land, subdividing this into smaller parcels of 5, 10, 20 or 40 acres, and selling these lots to the public (complaint, par. 4; answer, par. 4; Gross 296-98).

5. Individual respondents Sydney Gross and Edwin Kritzler, of the same business address, are alleged to formulate, direct and control the activities of the above corporate respondent (complaint, par. 1; answer, par. 1).

6. Respondent Gross and members of his immediate family own the

above corporate respondents (Gross 302–03; CX 13L).[2] Mr. Gross, a real estate broker, financed the purchase of the subject properties by the corporate respondents (Gross 296, 307). [5]

7. Respondent Gross, d/b/a Sydney Gross Collection Agency, is the sales agent for SWS (Gross 296; Shonfield 1245). That entity shares the function of sales agent for GVA and GVA II with Blue Chip Realty, another Gross enterprise (Shonfield 1245).

8. Mr. Gross' primary duties for the corporate respondents are financial and policymaking (Gross 314–15). Respondent Edwin Kritzler, also a real estate broker, shares in policymaking responsibility, and in addition is generally responsible for the day-to-day operations of the three companies, reporting to Mr. Gross (Gross 314; Kritzler 462–68). Mr. Kritzler, a vice president of SWS, serves as the general manager for each of the three corporate respondents (Kritzler 467).

9. Together Mr. Gross and Mr. Kritzler selected the three properties purchased by the corporate respondents (Gross 312). They decided upon the resale prices to be charged, the promotional materials and TV commercials, as well as the contract forms (Gross 309–12).

10. Respondent Porter Realty, Inc. through agreement signed by its president, respondent Irvin Porter, was retained by SWS in June 1974 to sell its land (CX 37). In addition, Porter also sold land in GVA and GVA II (Kritzler 592–93). These arrangements ceased in March 1978 (Kritzler 637; Porter 2359; Elfont, 4167).

II. THE PROPERTIES

11. As noted, this case involves the sale of undeveloped land in three subdivisions, *viz.*, SWS, GVA and GVA II, which in the aggregate total approximately 40,000 acres. The location of these properties is in Culberson and Jeff Davis Counties, Texas (complaint, par. 4; answer, par. 4).

12. I, the Administrative Law Judge, personally toured and observed these lands, accompanied by counsel, on July 1, 1981. During subsequent hearings held later in the year in Van Horn, Texas, I had a second opportunity to observe the general vicinity of the properties. From time to time this initial decision may reflect the result of my observations. [6]

A. *Southwest Sunsites*

13. The Southwest Sunsites tract was acquired by respondents in 1973.[3] This land is located approximately 10 to 20 miles east of the

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[2] None of these family members is involved as a practical matter in the business activities of the corporations (Gross 303–04).

[3] Technically, SWS was purchased by SWS, Inc., following a loan for this purpose to it by respondent Sydney Gross. The purchase price was $469,857.50, which breaks down to a cost of $20 to $33.50 per acre (CX 3; Compere 3263; Gross 307).

town of Van Horn, Texas, itself located approximately 120 miles east, and somewhat to the south of El Paso. The property lies to the immediate north of Interstate Highway 10 (CX 86G–H; CX 87E–F).

14. By way of background, SWS originally contained about 20,000 acres (Bray 3770), generally being used as grazing land (Wolfe 4568). In 1968, it was sold by one, Hugh Wolfe, to Southwest Land Corp., which began to subdivide and sell the property (Wolfe 4551; Bray 3770). Approximately 2,000 acres of this property was sold in bulk to certain purchasers from Chicago (Wolfe 4552–53).[4]

15. In 1973 Southwest Land Corp. declared bankruptcy, and the property was repossessed by Mr. Wolfe. Subsequently, in December, 1973, the land was sold by Mr. Wolfe to respondents (Kritzler 474; Wolfe 4552; CX 3, 4A–C).[5]

16. SWS, consisting of 17,467 acres, is located entirely in Culberson County, in an area known as Wild Horse Valley, immediately north of Michigan Flats (Reed 2608, 2624; Compere 3227; RX 67 at 4).[6] This valley lies generally between the [7] Sierra Diablo Mountains and the Diablo Plateau on the west, and the Apache Mountains on the east (RX 67 at 4, 33).[7]

17. SWS is subdivided into approximately 1,800 parcels of 5, 10, 20 and 40 acres.[8] The larger lots are located in the eastern portion of SWS, where the property enters the foothills of the Apache Mountains, with its rougher topography.

18. Before its purchase by respondents, the western portion of SWS had been subdivided into 5 acre parcels by Southwest Land Corporation (Kritzler 4093). Subsequently, the eastern portion was platted by respondents under the name Sunsites Ranche (Lara 3883, 3885). (For purposes of this case, the name distinction does not appear to be significant, although the two properties used different contract documents and have different sized parcels.)

B. *Green Valley Acres and Green Valley Acres II*

19. Green Valley Acres was acquired by respondents in 1976.[9] This

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[4] These 2,000 acres, located in the center of SWS, were never platted (Wolfe 4552; Lara 3884). In August, 1981, it was reacquired by Mr. Wolfe at a cost of $100 an acre (Wolfe 4552–53).

[5] Respondent Kritzler testified that Southwest Land Corporation is in no way affiliated with the respondent SWS enterprise (Kritzler 647). Mr. Wolfe testified that SWS in reality "took over" the contract he had with Southwest Land "through the bankruptcy court," with both parties honoring previous sales of parcels to the public (Wolfe 4552).

[6] Wild Horse Valley is sometimes referred to as Wild Horse Flat or Flats (RX 67).

[7] The Baylor and Beach Mountains also lie to the west of the SWS property, and the Wylie Mountains lie to the south (*See, e.g.*, RX 67, figure 7).

[8] Mr. Kritzler furnished the following "ballpark" breakdown: 650 5 acres; 500–700 10 acres; 100 20 acres; and 100 40 acres (Kritzler 481).

[9] The purchaser of record in this instance was respondent Sydney Gross. Respondent Kritzler executed the contract as "attorney-in-fact." The purchase price was $750,000, which breaks down to a cost of $40.48 per acre (CX 15; Compere 3271–72).

property is located from 18 to 25 miles south of Van Horn (Kritzler 488; CX 88; CX 89).

20. GVA, consisting of approximately 15,000 acres in Culberson and Jeff Davis Counties, is located in an area known as Lobo Valley (Kritzler 491; Reed 2608–09).[10] This valley is bordered by the Chispa Mountains on the east and the Van Horn Mountains on the west. GVA is in the western portion of Lobo Valley, and the western border of the property extends into the foothills of the Van Horn Mountains (Reed 2608–09; Holtz 3036; RX 67, figure 11). [8]

21. Prior to its purchase by respondents, GVA was used for grazing and some farming activity (Gross 309). Subsequently the property was subdivided into approximately 1,200 parcels of 5, 10, 20 and 40 acres.[11]

22. GVA II was acquired by respondents in 1977.[12] This property is located in close proximity to GVA, in Lobo Valley south of Van Horn (Kritzler 488).

23. GVA II consists of 9,611 acres (Compere 3273). As in the case of the other properties, this property was similarly subdivided by respondents, into approximately 900 parcels. Because of the roughness in the terrain in the southern portion of GVA II, surrounding Needle Peak (RX 37), the land there was subdivided into 40-acre parcels. According to Mr. Kritzler, the use of this land is intended to be for camping or hunting (Kritzler 4098–4100; Gilmore 3961).

III. RESPONDENTS' MARKETING PRACTICES

A. *The Houston And Dallas Offices*

24. Respondents opened sales offices in Houston in 1973, and in Dallas in 1975, to sell SWS land (Kritzler 475). Upon the acquisition of GVA in 1976, and GVA II in 1977, both sales offices were charged with selling these properties as well (Gross 375).[13] [9]

25. Mr. Ted Rose was hired as a salesman by respondent Gross upon the opening of the Houston office (Rose 677–78).[14] Mr. Rose remained in that capacity for a period of some months, following which he became operations manager (Rose 679). In 1975, he was sent to Dallas to open up and manage that office (Rose 679–81). Mr. Victor Novaez eventually succeeded Mr. Rose as manager of the Houston office (Kritzler 475–77; Novaez 858).[15] Both office managers reported directly to respondent Kritzler, and Mr. Novaez testified that Mr. Kritzler

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[10] Lobo Valley is sometimes referred to as Lobo Flat (RX 67).

[11] Mr. Kritzler furnished the following approximations: 200 five-acres; 800 ten-acres; 100 twenty-acres; and 100 forty-acres (Kritzler 489).

[12] Green Valley Acres, Inc. was the "purchaser" of record in this instance, with execution by Mr. Kritzler. The purchase price was $602,550, which breaks down to a cost of $60.64 per acre (Compere 3272–73).

[13] There is some testimony which indicates that, at least in the Dallas office, sales efforts were concentrated on GVA and GVA II, following their appearance on the market (Rose 684).

[14] As it happened, Mr. Rose's father was a cousin of Mr. Gross's wife (Rose 677).

[15] Mr. Novaez began as a salesman in the fall of 1976, and became operations manager in the spring of 1977, replacing a Mr. James Layne (Novaez 858–59).

kept a close watch over the Houston office, visiting it personally "probably every three weeks or so" (Novaez 863; *see* Rose 688 and Novaez 862).

26. Both the Houston and Dallas offices remained open and active until 1978 (Kritzler 475; Rose 679, 686; Novaez 858). While the number of salespersons tended to fluctuate, as many as eight or nine persons were engaged in sales activity during peak periods (Kritzler 476; Hammer 649; Rose 682; Novaez 884). The operations managers were authorized to hire, supervise and fire office personnel, while respondents Gross and Kritzler maintained control over sales policies and contractual terms (Kritzler 476–77, 584; Rose 688–89; Novaez 861).

27. Respondents' Houston and Dallas sales personnel did not operate under written contracts of employment (Gross 376–77; *see* Hammer 651; Novaez 859–60; Rose 694). Previous sales or real estate experience were not prerequisites for employment (Rose 696; Hammer 650–51).[16] Compensation was solely by commission (Hammer 651–52; Rose 687).[17] [10]

28. There were no organized formal training sessions for newly-hired sales personnel. Neither were there any training manuals (Kritzler 587; Hammer 652–53; Rose 697; *see* Novaez 864–65). Prior to being sent out alone, a newly hired salesman would be provided with sales materials, given instructions what to say, and accompanied by experienced salesmen on their visitations for a few days (Hammer 652–54).

29, It was the testimony of respondent Edwin Kritzler that, under company policy, salesman were basically limited in their presentations to the written words contained in the brochure (CX 87), the fact sheet (CX 79), and the contract (CX 74) (Kritzler 4107). All sales personnel who testified maintained that they did not deviate from this policy (Hammer 652, 657, 660; Rose 695, 698, 714–17; Novaez 861, 864).

30. In respondents' Houston and Dallas operations, leads were typically generated through media advertisements, on TV, radio or in the newspaper, Interested prospects responded to an answering service (Rose 689; Novaez 871).[18] Subsequently, these callers were contacted by phone by employees of respondents (apparently women in the "phone room"), who undertook to answer preliminary questions. Arrangements would then be made for a personal visit by a salesman

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[16] Most of respondents' sales personnel were not licensed to sell real estate in Texas (Rose 696; Hammer 650–51, 654). It appears, however, that a salesman's license was not required in Texas during the relevant time period (Hammer 673; Rose 696). In any event, Mr. Kritzler testified that he had a Texas broker's license (Kritzler 589–90).

[17] Total commission amounted to 10% of the selling price. This included 70%–75% of the downpayment, with the remainder being paid the salesmen as "residuals," so long as the purchaser continued payments on the contract (Novaez 860).

[18] In Houston, the volume of calls was at one point "so heavy," that 10 or 12 or more lines were needed to handle the responses (Novaez 872).

(Rose 690; Novaez 873–74).[19]

31. If the salesman was successful in his efforts, a purchase agreement would be executed (CXs 74–78). While, as noted, the salesman was not authorized to alter the purchase prices set by Messrs. Gross and Kritzler, he was permitted a certain leeway in negotiating the down payment (Rose Tr. 689). All purchase agreements declare themselves not to be binding contracts prior to acceptance by respondents' home office (CXs 74A, 75A, 76A, 77A, 78A).[20] [11]

32. Both the Houston and Dallas offices became inactive in 1978, although mailing addresses were still maintained in those cities at the time of trial (Kritzler 475–77; R. Ad. 354, 355). Mr. Novaez, in Houston, attributed the diminished market to "saturation", but testified that he still answers a telephone for Green Valley (Novaez 884, 888).

B. *Respondents' Home Sales*

33. In or about the latter part of 1978, respondents commenced selling parcels from their home office in Encino, California (Gross 375–76). Two salesmen were used for this purpose, Mr. Brody and Mr. Frank, neither of whom were called as witnesses (Kritzler 565–66). These salesmen did not solicit new customers, but merely contacted previous purchasers for the purpose of selling them additional land (Kritzler 565).

34. According to Mr. Kritzler (Kritzler 566):

> They would call the customers that were on the books, tell them of recent events in reference to the property; and if there was a parcel of land that was next to theirs and they appeared interested, to sell them that piece of land.[21]

C. *On-Site Sales*

35. According to Mr. Kritzler, respondents do not have an on-site sales program, as such (Kritzler 474). However, since approximately 1975, respondents have employed an on-site representative whose duties have included selling land when the occasion called for it (Kritzler 471–72). Mr. W.D. Smith was respondents' representative until 1978, when he was replaced with Mr. Gilmore (Gilmore 983). [12]

36. Mr. Smith testified that he sold "some" (Smith 941) and "very little land" (Smith 917), although he was authorized to sell all three properties at the standard 10% commission (Smith 913).

36a. Mr. Gilmore, who described himself as an "on-site salesman," had previously worked as a salesman for Southwest Land Corporation (Gilmore 983–84). He testified that since the inception of his employment with respondents in November, 1978, he had only sold about eight pieces of the three properties (Gilmore 984–85). He also stated that no on-site sales had been made for about one year prior to his appearance as a witness in April 1981.

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[19] Salesmen were assigned by Mr. Rose on a rotational basis (Hammer 655–56).

[20] CXs 74 and 75, pertaining to SWS are entitled "Purchase Agreement." The forms pertaining to both Green Valley properties are entitled "Agreement for Deed and Purchase of Real Estate."

[21] Mr. Brody apparently passed on information concerning a newly-built cotton gin, and concerning a rubber producing "Guayule" plant (Kritzler 567–74). If Mr. Brody was unable to make telephone contact, the customer would be sent a "special memo" requesting a collect call to Mr. Brody (CX 115).

D. *Sales Through Brokers*

37. In addition to their own efforts, respondents have engaged the services of independent real estate brokers to sell their properties. Respondents provided these brokers with brochures, fact sheets and contract forms (Gross 383–84). The purchase prices for the properties and the terms and conditions of sale were established by respondents (Kritzler 591–96).[22] Brokers had no authority to alter these terms, and respondents retained the right to approve or disapprove all sales (Kritzler 593).

38. Following the formation of SWS, Inc., a broker named Mr. O'Brien was hired in Boston, Massachusetts (Kritzler 470). Mr. O'Brien performed in this capacity for approximately nine months or a year (Kritzler 470).

39. For a brief time respondents also employed broker services in El Paso, Texas in the mid-1970's (Kritzler 470).

40. But it is the events which occurred by virtue of respondents' arrangements with Porter Realty of Coral Gables, Florida, which form the focus of the broker-sales aspect of this case. [13]

41. As heretofore noted, the listed respondents in the caption of this case include the names of Porter Realty, Inc., and its president Irvin W. Porter (*supra*, p. 2). Because of the execution of a consent agreement the charges against them were not litigated in this proceeding.

1. Sales Through Porter Realty

42. Respondents dealings through Porter Realty commenced in June, 1974 and lasted until April of 1978 (CX 37A; Kritzler 4117; Porter 2262, 2336).

43. Porter Realty was incorporated in Florida in 1972 (CX 33). Its principal base of operations was in Coral Gables, near Miami (Kritzler 585).[23] During the time of its association with respondents, it sold only respondents' properties (Porter 2263).

44. Porter Realty used both in-house personnel and outside sub-

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[22] *See* CX 37A, para. 2. This agreement between respondents and Porter Realty with regard to SWS sales is the only such written agreement in evidence. Apparently agreements with Porter to sell other properties of respondents', as well as respondents' agreement with other brokers, were made orally (Kritzler 592–93).

[23] Prior to its arrangements with respondents, Porter Realty (and especially Mr. Irvin W. Porter) had been involved in selling other properties (Porter 2238–39, 2241–45). At least one of these properties was located in the vicinity of Sanderson, Texas, which according to the map is located in the southwestern part of the state (Porter 2242).

brokers to sell respondents' properties.[24] Unlike respondents' own local operations in Houston and Dallas, Porter did not employ media advertising (Porter 2325). All, or virtually all, of its selling was done by telephone (Porter 2325).

45. To obtain leads, customer lists would be purchased from any one of the numerous land sales companies which had such lists available (Porter 2325). The lists consisted of the names of previous purchasers of land. These prospects would then be [14] contacted by telephone (Porter 2325).[25] In this manner sales were made throughout the United States (Porter 2325).[26]

46. The record shows that Porter Realty was very successful in selling respondents' properties. In fact, the company outsold all other sellers, even respondents' sales force which ranked number two in such sales (Kritzler 591). It was Mr. Kritzler's testimony that Porter accounted for approximately 55% to 60% of all sales, and up to 70% in 1977 (Kritzler 591, 4117).

47. According to more specific information in the record, even these figures may be on the low side. Mr. Kritzler's estimate of the number of present purchasers of respondents' three properties totals 2,600 (Kritzler 481, 490, 492 (SWS-1400; GVA-650; GVA II-550)). The number of purchasers reported by Mr. Porter totals 2150 (CX 38B). If these figures are accurate, and my calculations correct, the resultant overall percentages of Porter sales of respondents' properties would be over 80%.

48. As noted, respondents terminated their business relationship with Porter Realty in April, 1978. Respondent Sydney Gross described this action as "mutual," and indicated that sales had been tapering off (Gross 381–82). According to Mr. Porter, "it was sort of a 50/50 affair", with respondents desiring "to get out of the phone business" (Porter 2336). Mr. Porter further testified that respondents Gross and Kritzler felt that "there might be too much being relied on about oil or whatever" (Porter 2359).

49. In the view of Mr. Kritzler, the reason for the termination was the steadily increasing instances of representations by Porter sales personnel concerning oil exploration activity on respondents' GVA and GVA II properties (Kritzler 596–97, 4126). While earlier complaints about Porter representations had involved whether purchasers would be able to resell their properties at a profit, "toward the end of 1977 and the beginning of 1978 the oil situation did arise" [15]

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[24] Mr. Porter testified that the greatest number of persons employed at any one time to sell the properties were approximately 12 in-house and 5 or 6 sub-brokers (Porter 2255).

[25] The lists purchased by Porter Realty would be given only to in-house personnel. It was left up to the sub-brokers to obtain their own leads. For this reason, and for using their own telephones and facilities, sub-brokers were entitled to a higher commission on sales (Porter 2326, 2251–52; CXs 437–42).

[26] Calls were not placed to every state, however. Mr. Porter explained that there were a "handful" of states where such method of solicitation was not permitted (Porter 2325).

Kritzler 598). According to Mr. Kritzler, the percentage of Porter sales involving oil representations rose during that time from 10% to perhaps 60% (Kritzler 598).

50. Of particular objection to Mr. Kritzler was the use by Porter salesmen of an "oil map" (CX 129A–C). While Mr. Porter testified that Mr. Kritzler was aware of its use by Porter Realty, Mr. Kritzler testified that he did not become aware of this use until "the late fall of 1977," and that respondents had not previously authorized its use (Porter 2314; Kritzler 4124–25). Mr. Kritzler stated that he "[c]alled Porter immediately and told him not to use the map, that it was outside of his jurisdiction to do that" (Kritzler 4125). When in early 1978, Mr. Kritzler learned of its continued use, he testified that he again "told him to absolutely discontinue using the map" (Kritzler 4126). When the use of the map continued, and further instances of oil representations occurred, respondents, according to Mr. Kritzler, terminated the association with Porter Realty (Kritzler 4126).

2. Sales Through Diversified Realty

51. Respondents also employed the services of another Miami area broker, Diversified Realty Investment Corporation (Gross 377–78).[27] Diversified was not listed as a respondent in this case, and its principal officer, Mr. Louis Beck was not called as a witness (Gross 391–92; Kritzler 609).

52. Diversified accounted for the third largest total sales of respondents' properties, following Porter Realty and respondents' own sales force (Kritzler 591).

53. As in the case of Porter Realty, respondent Kritzler became aware of problems arising from Diversified's sales representations (Kritzler 609). Generally speaking, their problems were of the same nature as those associated with Porter, *viz.*, quick-profit-resale and oil (Kritzler 610). In approximately early 1978, Mr. Kritzler came to learn that Diversified too was using an oil map (Kritzler 610–12). [16]

54. As Mr. Kritzler put it: "In the beginning they [number of oil complaints] were smaller and then they grew to a proportion which caused us to dismiss them as a broker" (Kritzler 610).

55. CX 221 is a letter dated February 24, 1978, from Mr. Gross to Mr. Beck terminating their relationship in view of Mr. Beck's "recent difficulties with the Federal Grand Jury, regarding your association with another land company." Mr. Gross testified that this was a reason for termination, and that a possible additional reason might have been "one or two" complaints regarding Diversified which Mr. Kritzler handled (Gross 391).

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[27] Diversified's employment with respondents probably commenced in the year 1976, when GVA came on the market (Gross 381). That company apparently sold GVA and GVA II property, not SWS (Gross 738).

3. Sales In South Pacific

56. A broker named Mr. Holgin was engaged by respondents in 1978 to sell GVA II property in the South Pacific (Kritzler 586, 612; Gross 382). This relationship was apparently ended in 1980 (Kritzler 586–87). Mr. Holgin's activities included sales to citizens of Tuvalu, a small island nation in the South Pacific (Gross 390). Mr. Kritzler testified that subsequently a group of Tuvalu purchasers visited their Texas properties, accompanying a Mr. Lauti, the Prime Minister, who apparently was himself a purchaser (Kritzler 621, 4145–47).

IV. COUNT I

57. As earlier noted, Count I of the complaint charged respondents with falsely representing the SWS, GVA and GVA II properties as being a good investment at the offered price, with little or no financial risk involved.

A. *The Representations Concerning Investment And Financial Risk*

1. TV and Radio Advertising

58. As previously found (Finding 30), respondents employed TV and radio advertising in their Houston and Dallas operations. TV advertising was also done at various times in **[17]** Boston, Atlanta and Midland, Texas (R. Adm. 4, 5, 6, 7, 11, 21).[28]

59. CXs 42 through 71 were admittedly utilized by respondents as scripts for the preparation of TV and radio advertising for SWS, GVA and GVA II (R. Adm. 17). The two commercials whose script appears on CX 72B were aired on KHTV in Houston in April-June 1978, approximately 80 and 110 times, respectively (R. Adm. 13, 14, 15, 16). CX 395 is a TV commercial script also aired in Houston, in 1977 (Kritzler 579–81).

60. I have examined these materials and can find no reference in them, with one or two possible exceptions, to investment or accompanying financial risk. While the point is emphasized that the offered price is affordable, the messages are all oriented toward the uses which may be made of the land by purchasers, not resale profitability. Over and over again the theme is repeated: *viz.,* fertile valley; sunshine; clean air; quiet environment; mountain scenery; abundant water; farming; ranching; hunting; camping; retirement; satisfaction in owning land. While "combating inflation" is prominent in several of the scripts, it appears nearly, if not always, to be in the context of using the property to produce one's food, thereby reducing expenses (*See* CXs 51, 52, 58, 59, 60).

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[28] The abbreviation "R. Adm." used in this portion of the initial decision refers to respondents' responses to complaint counsel's requests for admissions. These responses are dated October 14 and December 11, 1980.

61. On the other hand, CX 43, in offering inflation protection advice, contains the statement "Land is always your best buy." This representation is set forth in a context which includes references to an individual's independence, the fertility of the land, and the availability of water.

62. Only one of the scripts mentions the word "investment," CX 58 (it was crossed out in CX 43, above, and the word "buy" substituted). It refers to "five acres of fertile farm and investment property." This is represented as "the answer to inflation and the drugery of city life." The script goes on to state (CX 58):

> Your five-acre site is awaiting you near the pleasant West Texas [18] community of Van Horn . . . where the soil is fertile and water plentiful. This fertile land will grow fruits, vegetables, meat and poultry . . . for your *own* table as well as sale to others. So stop worrying about inflation and the hectic city life. Think about it! Your own five acres of fertile land. . . .

Another script speaks of "just holding [the land] for the future," as an alternative to using the property for hunting and farming (CX 67). This material features a "celebrity", James Drury, the Virginian. Mr. Drury or his name also appear in other scripts, which often contain references to the hunting available on or in the vicinity of respondents properties (CXs 61–68, 72).[29]

2. The Brochures, Fact Sheets And Contracts

63. According to respondents, their sales policy from the beginning was to furnish prospective purchasers only such information as was contained in the brochure (CX 87), fact sheet (CX 79) and the contract (CX 74; Kritzler 4097, 4107). Respondents sales representatives testified to like effect (Rose 695, 698, 714–15; Hammer 652, 657, 660; Novaez 861).

64. In examining these documents, it does not appear that either the various fact sheets (CXs 79–85) or the contracts (CXs 74–78) contain any reference to or representation concerning investment or risk.

65. On the other hand, there are certain references to "investment" in the brochures (CXs 86–89).

66. CX 86A-N was the brochure used by Southwest Land Corporation prior to its going out of business in 1973 (*see* Findings 14, 15, *supra;* Kritzler 644). When sales of SWS [19] began, respondents continued to utilize the brochure for a period of perhaps 60 to 90 days (Kritzler 644). During this interim period respondents assertedly pre-

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[29] Other individuals featured in the scripts are a Dewey Compton, described as a "prominent" and "respected" agronomist (Kritzler 4096; CXs 44–52, 58–60); a Murray Cox (CXs 42, 53–55); a Harold Gunn (CXs 56–57, 72); and a Dick Gottlieb (CXs 43, 52).

pared their own brochure, CX 87A-L, which thereupon replaced CX 86A-N (Kritzler 645).

67. On CX 86B, the following statement appears:

> This is Van Horn, Texas. Home of Southwest Sunsites. The new prime investment spot in the Southwest.

68. On the replacement document, CX 87B, the second sentence of that language was revised to read: "The prime land spot in the Southwest."

69. Also on the same page of the old brochure, CX 86B, is the statement "Its the ideal spot for investors." This language remained unchanged in the new brochure (CX 87B).

70. On CX 86E, the old brochure, appears the statement "For the investor, Van Horn offers potential as rich as the land itself." The same statement is in the later SWS brochure (CX 87D).

71. On CX 86I, in answer to the question "What can you do with your five-acre sunsite?", it is stated:

> The land uses are almost limitless. Obviously, a five-acre or larger tract offers you infinitely more possibilities both as an investor, or a prospective resident, than the smaller lots generally offered by developers. The value of acreage in the Southwest is leaping every year. Last year alone, this land increased in value by over 20%. Its future growth potential is even greater.

72. This language was revised in the new brochure, CX 87J, to read:

> The land uses are almost limitless. Obviously, a five-acre or larger tract offers you infinitely more possibilities both as an investor, or a prospective [20] resident, than the smaller lots generally offered by developers. The value of acreage in the Southwest is leaping every year. Its future growth potential is unlimited.

Mr. Kritzler testified that the changes—the deletion of reference to a 20% increase in value, and of the statement concerning even greater future growth potential—were made because "we were not selling an appreciation of the land. We were selling use" (Kritzler 4103).

73. As for CXs 88 and 89, the brochures prepared for GVA and GVA II, which originated in 1976 and 1977, respectively, further changes were made (Kritzler 4103–06). There is no reference in these brochures to "investment" or "investor." According to Mr. Kritzler, these steps were taken because of the questioning by various regulatory agencies, state and federal, of the use of such terminology in connection with the sale of land (Kritzler 4105).

74. Apart from the foregoing, each of the brochures (CXs 86N, 87L, 88K, 89L) contains quotations of historical American figures concerning the monetary benefits which derive from land ownership general-

ly. Respondents' proposed findings describe these quotations as "aphorisms" (RPF 40), and Mr. Kritzler belittled reliance upon them as a basis for purchasing respondents' properties (Kritzler 4144).

3. Other Sales Aids

75. Both respondents' own salesmen, as well as its hired brokers, sometimes employed various pictures and articles in connection with their sales presentations to prospective purchasers.

76. I have examined these materials and can find little or no probative evidence that the land was represented as a good investment carrying little or no risk.

77. According to former salesman Hammer, CX 170B-Z20 is a "picture book" which was used by respondents' salesmen in home visitations. It contains "various and sundry pictures and articles relating to the area and to the property itself" (Hammer 662). The purpose of the "picture book" was, according to Mr. Hammer (Hammer 663): [21]

> Here, again, to help—for those that may be unfamiliar with the area, as to what they could expect when they got there. It was to how the land would look to them. It was raw land and some people just—you can't explain well enough for them to comprehend what raw land is. So we hoped that with these pictures we could make it a little clearer to them, what they could expect to find.

78. Apart from the pictures, there are a number of articles and statements in the book generally extolling the land (CX 1706V, X and Z-6, 17, 18, 20).

79. As earlier described, it was respondents' practice, following sales of property, to keep purchasers informed of newsworthy items generally affecting their purchase, or of specific interest in the Van Horn area (Gross 353–54). I have examined these materials, and cannot conclude from them that purchasers were thereby informed that they had made a risk-free investment.

80. These communications, often in the form of newsletters, include the following: CXs 90, 91, 92, 93, 94, 95, 96, 98, 99, 100, 102, 103, 109, 110, 111, 112, 113, 116, 117, 119, 120A-B, 127, 128, 131, 187, 170T, 237, 239, 242 and 491.

4. Representations To Purchasers

81. The former members of respondents' sales force who appeared in this proceeding uniformly testified that they had adhered to the policy of limiting the dissemination of material information to the documents furnished them by respondents for that purpose (Hammer 657, 660; Rose 698, 713–19; Novaez 866–71). Mr. Novaez, respondents' former Houston manager, testified that he never responded to a customer's question about investment, and would tell him to go to the

property personally and investigate, before answering the question for himself (Novaez 878–79). Mr. Smith, the on-site manager, testified that he "never told anybody they was going to get rich or be able to sell it for a profit" (Smith 940).

82. The testimony of complaint counsel's consumer witnesses does not reflect a pattern, at least on the part of respondents' employee sales force of good, risk-free investment representations (Baldridge 834; Buck 1498–1577; Sowell 2501–19). **[22]**

83. We turn now to analyzing more specifically the testimony of purchasers contained in this record.

84. There is nothing in the testimony of *Norma Baldridge* which goes to Count I of the complaint (Baldridge 804–36; *See* especially 833–34).

85. In her testimony, *Paula Bear* indicated that respondents' salesman represented the property as a good investment because of oil considerations and Texas A&M projects (Bear 1117–18). According to Mrs. Bear, she was informed that within 2 or 3 years the land would triple in value (Bear 1118). She later amended this testimony to "double or triple" (Bear 1168). However, an examination of her testimony reveals that it was so contradictory and her memory so faulty that it cannot be credited. The salesman's visit occurred in 1973, nearly 8 years prior to her appearance as a witness (Bear 1116). She admittedly was present for only about half of the sales presentation, and she admitted not knowing what the salesman said to her husband in her absence or what documents were furnished (Bear 1120, 1150). She agreed with respondents' counsel that she really didn't pay much attention to the transaction at the time (Bear 1161). Many other particulars can be recited, but it is quite apparent that Paula Bear's testimony is not reliable and probative enough upon which to base an accurate finding of fact.

86. Witness *Clement Switaj* testified that he was informed by a Porter Realty representative that he could profit from reselling his land, and that this could be done in a short period of time (Switaj 1276, 1279–80, 87). However, on cross-examination it was brought out that this witness understood that in making this investment he was incurring a risk, and that he nevertheless invested despite such risk (Switaj 1332–32).

87. Witness *Richard Morley* was allegedly informed by a Porter representative that the property was a short-term investment involving a 2 or 3 year period (Morley 1340–42). He testified that he believed he would make a "little money" based upon a possible resale of his land to Texaco, or if this fell through, make some money from "a little farming" during his retirement (Morley 1341, 1350–51). The witness, however, revealed himself to be aware that the Porter salesman's

alleged "deal" with Texaco could fall through, and that negotiations to buy or sell land do not necessarily work out (Morley 1379, 1382–84). He also realized there was an uncertainty as to resale prices (Morley 1383).

88. Witness *James Limpp* testified that he purchased GVA property from Diversified Realty on the primary representations [23] that oil might be found on the property and that Diversified would attempt to resell his land for him (Limpp 1391, 1394–95). Mr. Limpp expressed an interest only in a short term investment (Limpp 1399–1400, 1402). On cross examination the witness admitted that he knew there was risk in exploring for oil and further admitted that he knew there could be no guarantee as to any resale of his property by Diversified (Limpp 1422, 1433).

89. Witness *Daniel Grygleski* testified that his purchases of respondents' property were designed to be short term investments only, with quick resale (Grygleski 1446, 1453, 1456, 1474). It is clear from the record that he knew there was financial risk involved. He described his purchase as "a shot in the dark" and "gambling" (Grygleski 1473, 1488). On cross examination he acknowledged there was uncertainty with respect to resale of the land, and the price at which this could be done (Grygleski 1477–78).

90. Witness *Catherine Buck* testified she did not purchase her property as an investment but as a place to live (Buck 1502). The only reference to investment in her testimony concerns statements regarding the purchase of property for her 19-year old son. Allegedly he was told by respondents' salesman that purchasing property from respondents would be a "very good investment," in that "in a few years, double its value" (Buck 1503). On cross examination the witness agreed with counsel's characterization that if the land were held long enough he "might be able to resell it in the future for a profit" (Buck 1563). The witness further asserted that there was no certainty in her mind as to when the property could be resold (Buck 1564).

91. Witness *Pasquale Allienello* testified that he purchased respondents' property not to live there but solely as an investment with an eye to making a profit (Allienello 1624, 1626). Based upon what the salesman told him he thought that the property was a "good investment" (Allienello 1627). It is not entirely clear whether or not Mr. Allienello believed his purchase to be without financial risk inasmuch as his testimony is couched in terms of "profitability," "possibilities," and "potential" (Allienello 1624, 1651).

92. The testimony of witness *John Davis* cannot be credited because of the haziness of, or the total lack of recollection of, his memory. This point is amply illustrated in the record (*see* 1674, 1680–81, 1696–97, 1701, 1710–13).

93. Witness *Ronald Goldstein,* who was contracted by a representative of Diversified Realty by phone, testified that the propety was represented to him as a "fine" or "very fine" **[24]** investment, in view of oil and gas exploration in the area and of the land's potential for farming (Goldstein 1719, 1720–22, 1760–62). The witness recognized, however, that there are risks involved in purchasing land, with associated uncertainty as to when the land could be resold and at what price (Goldstein 1958, 1976–77).

94. Witness *John Lambert* testified that he purchased a parcel of respondents' property at the age of 19 upon the representation to him by respondents' sales representative Mr. Novaez, that it would be a good investment with the price sure to rise in the immediate future and that the property could be resold (Lambert 1284–88, 1297). Some months following this sale the witness received a phone call from "California" and he was solicited to purchase more property upon the representation that the price of the land was going up (Lambert 1288).

95. Witness *Steven Lueckel* testified that he was contacted by a Porter Realty representative concerning undeveloped investment property with quick turnover profit potential (Lueckel 1823). He was informed about proposed legislation concerning a product known as guayule from which rubber could be produced and which could be grown in certain areas of the southwest. Mr. Lueckel was allegedly told that rubber companies would repurchase the lands in the development, and that upon this occurrence the witness could expect to double his money or make higher profits in a matter of a few months (Lueckel 1823–25, 1827, 1829, 1831–32, 1834, 1868–69). On cross examination the witness agreed that he was not given any guarantees that these events would come about and that in fact he knew there were no guarantees (Lueckel 1865–66).

96. Witness *Ronald Robinson* testified that he purchased his parcel of land as an investment primarily, but secondly for the possible retirement of his father (Robinson 1915, 1933–34). Concerning investment potential, he testified that respondents' salesman stated (Robinson 1914):

> Well, he said that it wasn't something that would just be, you know, jumping up in price, you know, quickly over the next year or maybe two years. But over the next three, four, five years, within that period of time it would be worth more than—much more than what it is—than what I was buying it for.

The witness did not assert that he believed his investment would be risk free, but did testify that he believed the salesman's **[25]** representations (Robinson 1934). Mr. Robinson did agree, however, in connection with certain property he owned in Alaska, that there was no certainty as to when he would be able to sell that land or for what price (Robinson 1927).

97. The witness *John Sweets* testified he was told by Porter Realty salesman that purchasing respondents' properties would be a good short term investment with a quick turnover at a good profit (Sweets 1948–53). The witness, aged 72 and retired, testified that this is what interested him in making his purchasing decisions, and that he was also impressed by the exploration for oil in the area (Sweets 1946–47, 1959). On cross exmaination however, he gave the following candid testimony (Sweets 1972–75):

> Q. And you know that there is no such thing as a sure thing; correct?
>
> A. That's right.
>
> * * * * * * *
>
> Q. You still know it now; and you knew it [that there is no such thing as a sure thing] when you bought your first land in Texas, didn't you?
>
> A. That's right.
>
> Q. You knew it when you bought your second land in Texas, right?
>
> A. That's right.
>
> Q. No way of knowing how long it'll take before you earn [any] profit, and no way of knowing even if you will turn a profit; correct?
>
> A. Absolutely not.
>
> Q. And there's no way of knowing how much of a profit you will make if you make a profit; correct?
>
> A. If you are talking in absolute terms, I suppose that would be correct. **[26]**
>
> * * * * * * *
>
> Q. You've known all along that there's no such thing as certainty on these purchases?
>
> A. That's evident.
>
> Q. In fact, when you made your first purchase in Texas, your attitude going into it was you'd buy it, hold it for two years and see what happens. Either you'd make a profit or you'd cut your losses; isn't that correct?
>
> A. Right.
>
> Q. And if you didn't make a profit, you would just default on your land and give up [on it]—this would be one investment that didn't work out?
>
> A. That's right.
>
> Q. And that's the attitude you went into it with, wasn't it?
>
> A. That's right.
>
> Q. And you had the same attitude with your second Florida—your second Texas purchase; is that right?
>
> A. Right.

98. The witness Sweets described his experiences in purchasing respondents properties as a "gamble" (Sweets 1977).

99. Witness *Ernest Smith* testified that he purchased respondents' property solely on an investment basis, interested only in resale profit. According to the witness, he was told by the Porter representative that she would resell the 10-acre parcel within two years at a good profit (Smith 2064–65, 2070). In fact, because of the witness' insist-

ence, in two years Porter Realty did resell five acres of Mr. Smith's purchase for a **[27]** substantial profit.[30] Upon the default of this purchaser, respondent Mr. Kritzler accorded Mr. Smith a full refund (Smith 2094; RX 8B). It is difficult to assess the import of this witness' testimony inasmuch as his purchase of respondents' property was expressly only in a "hope" of realizing a profit (Smith 2066) and because of the fact that he was an experienced purchaser of undeveloped land for investment purposes, and a person who had declined to purchase on numerous occasions (Smith 2101–02).

100. Witness *Howard Schlachter* testified that he purchased his property for investment purposes based upon representations of the Diversified Realty salesman that within two years the property could be resold at a profit (Schlachter 2111, 2114, 2117). Initially he testified that he could not recall any specific representations concerning specific dollar amounts of profit. He subsequently placed this figure as doubling the amount of his investment. Although the witness asserted at one point that his memory was "perfect" (Schlachter 2128), the record shows many instances of deficient recollection (Schlachter 2111–12, 2115, 2118, 2122, 2124, 2130–31, 2136–37). In any event, on cross examination the witness conceded that there is financial risk associated with any investment, including his purchase from respondents (Schlachter 2135a-b, 2138–39).

101. The testimony of witness *Otis Rawlins* does not support the allegations of Count I of the complaint. Mr. Rawlins, a professional real estate man for approximately 42 years (Rawlins 2146), purchased his property in Texas for use as a possible future homesite as well as for potential resale (Rawlins 2149–50, 2165). Indeed, the record shows that the property was subsequently resold by Porter Realty to a third party for nearly twice what Mr. Rawlins originally paid for it (Rawlins 2166). On cross examination Mr. Rawlins made clear his belief that resale at a profit had not been guaranteed by Porter, and that the discovery of oil on the property was not a certainty (Rawlins 2181–82).

102. Witness *Donald Stein* testified that he purchased his parcel on the representation of Porter Realty that this was a good short-term investment and that the property could be resold at double the money invested (Stein 2202–05, 2221–22). The **[28]** witness testified that he relied upon these representations on making his purchase. On cross-examination, he acknowledged that all short-term investments do not work out (Stein 2118–21).

103. The witness *Dr. Robert Danskin* testified that he made two purchases of respondents' property upon representations by Porter

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[30] Mr. Smith purchased 10 acres of SWS in 1976 for $6,990. In 1978, five acres of this was sold for somewhat in excess of $6,000 (Smith 2098).

Realty that the land was a good buy and that the Van Horn are
would grow and develop commercially in a number of respects (Da
skin 2421–22, 2126, 2129, 2459). The witness stated that he purchase
this land for capital appreciation and resale (Danskin 2426). Th
record shows that the witness, a dentist, is an experienced invest
with holdings in an orange grove, rental property, stocks, bond
gems, gold, antique firearms, farmland, oil and gas drilling and v
cant land (Danskin 2444–46). The witness recognized in his testimon
that he did not know of any investment that is perfect; that there
always some risk in an investment, and that he recognized when h
purchased the properties in issue that there was risk involved (Da
skin 2477).

104. The witness *John Swanson* testified that he purchased r
spondents' properties upon Porter Realty representations that it wa
open development property with good potential for resale (Swanso
2463). In addition, the witness was informed concerning oil activity i
the area (Swanson 2468, *see also* 2469–71, 2475, 2477). Concerning oi
the witness stated he believed "that possibly there might be som
extension of this activity where these mineral rights might result i
some value to me" (Swanson 2471). On cross examination, he acknow
edged that he knew of the risk and uncertainty in making his pu
chases (Swanson 2485–86).

105. Witness *Hugh Sowell* testified that the main reason for h
purchase of SWS property was the endorsement of Mr. Dewey Com
ton in his appearances in respondents' TV commercials. The princip
purpose for his purchase appears to be its use as a possible retireme
home, although at one point in his testimony he did mention th
possibility of investment (Sowell 2516). Mr. Sowell further testifie
that the SWS salesman represented "that your property would neve
go down, it had only one way to go, it would be up" (Sowell 2507–08
There is nothing in his testimony which establishes whether th
witness believed that any financial risks were involved (Sowell 2501
20).

106. According to witness *George Munch,* the land was represente
to him by Porter Realty as a great opportunity to make a little mone
and a good profit and that he could at least double his money i
possibly a year (Munch 2524, *see also* 2553–57). According to th
salesman, the inherent value of the land **[29]** for use in gardenin
included the availability of water, the economic development in th
Van Horn area, including the possibility of a nuclear plant bein
built, and the fact that there was oil in the vicinity, convinced M
Munch "that it was a very good deal," whereas "at first it all sounde
too good to be true" (Munch 2526). Mr. Munch was cross examined
length as to whether there were risks and uncertainties associate

with his purchase. The witness' responses to this series of questions were to the effect that there are risks generally in business and other investments; and that while there was no guarantee of profits, and while he had a "little doubt" about the matter, that based upon his experiences in selling his Florida properties for double the prices he paid, that he believed the salesman from Porter would be able to resell his land for double the amount paid, so that he was "reasonably sure that he would make a real good profit" (Munch 2543–57).

107. None of the consumer witnesses who testified on respondents' behalf indicated that they were told the land was a good investment or that it was without risk. (Wharton 3565–3618; Muller 3619–3639; Sanchez 3683–3713; Perkins 4019–4043; Smallwood 4045–4087; G. Taylor 4587–4605; W. Taylor 4606–4621; Townsend 4622–4634).

5. The Situation Concerning Oil

108. There is no showing in the record that respondents' employees made representations concerning oil. In fact, the showing is to the contrary. *See* the testimony of respondents' in-house sales representative witnesses, Rose 678–721; Hammer 648–73; Novaez 857–902; W.D. Smith 904–77; Gilmore 983–1028. *See also* the testimony of purchaser witnesses, Baldridge 804–36; Buck 1498–1577; Lambert 1779–1815; Robinson 1904–44; Sowell 2501–19; Muller 3623; Smallwood 4048, 4081; G. Taylor 4594; Townsend 4625.

109. From 1974, when Porter Realty first began selling respondents' property until mid-1977, there were no references to oil in the sales presentations by Porter Realty's sales representatives which came to respondents' attention. Beginning in late 1977, according to respondents, it was learned that employees of Porter Realty and Diversified Realty had begun to make statements concerning the possibility that oil might be discovered in or near GVA II (Kritzler 598, 4122; Elfont 4183). Such representations were less often made about GVA (Kritzler 642). The record does not evidence that oil **[30]** representations were made about SWS (Kritzler 642; Elfont 4168).[31]

110. As we shall see, there were four alleged representations concerning oil: companies are exploring for oil in the area of the properties; oil is being produced in northern Culberson County; there is a possibility that oil could be discovered on or near GVA and GVA II; and a map showing land ownership and oil production was given to some customers.

111. Some witnesses testified they were told that oil exploration was underway on or near GVA and GVA II (Swanson 2474; Goldstein

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[31] Respondents acknowledge that oil representations increased during the last few months before respondents terminated their relationship with the brokers (Elfont 4185; Kritzler 4121). They claim, however, that although the percentage increased rapidly, the number of such representations did not. Respondents point out that the total number of sales was rapidly decreasing in late 1977 and early 1978 (Elfont 4170).

1719, 1760; Grygleski 1473). Others were told that such exploration might begin in the future (Limpp 1421).

112. According to the record, this representation was factually correct; there is evidence which shows that exploration did occur on the properties themselves and in the immediate vicinity (*see* Gilmore 998, 3978; Sanchez 3711; W.D. Smith 928, 955, 973; Wolfe 4570; Reed 2631; Watkins 2724, 2740, 2742, 2745; Conoly 1095; Case 4519–25, 4538; RXs 64, 65, 75).

113. Some customers were informed of the oil production in northern Culberson County (Swanson 2475, 2477; Danskin 2425; Elfont 4183).

114. According to the record, these statements were accurate (Watkins 2717–18, 2723, 2725; CXs 101, 135, 166N).

115. Several purchasers testified that they were told that no oil had yet been discovered or produced on respondents' properties themselves (Swanson 2475; Stein 2220; Limpp 1422; Grygleski 1492; Allienello 1653; Sweets 1986; Switaj 1280).

116. The witness who claimed to have been told there was a potential for discovery of oil on the property testified that they were informed that such discovery was only a possibility, **[31]** which could not be predicted with any degree of certainty (Limpp 1422; Grygleski 1473, 1492; Goldstein 1776; Sweets 1977; Rawlins 2181; Stein 2203, 2220–21). No witness testified that he was told that oil had already been discovered on his property.

117. The record shows that GVA and GVA II are surrounded by a major oil-producing area to the northeast (Watkins 2717, 2723), a smaller producing area to the east (Watkins 2736), and an area of major exploration by Texaco to the south, southwest, and west (Watkins 2724, 2729–36). The properties may possibly lie within the West Texas Overthrust Belt, a geographic formation which many experts believe contains oil (Watkins 2753–54). Texaco owns and leases substantial amounts of land and mineral rights in the immediate vicinity of the properties (Watkins 2745; CX 129).

118. The record contains evidence of oil exploration in and near the properties. Such exploration does not occur unless there is some perceived potential for discovering oil (RX 75 at 13–16). The results of a survey by Geotronics, Inc., which actually included magnetotelluric stations on GVA, were priced at $97,530 (RX 65). Results of the survey were purchased by several different customers (RX 75 at 16–17).

119. Records of the General Land Office of the State of Texas show 144 current leases of mineral rights within a 60 mile by 60 mile area centered in Van Horn (RX 76). Most such leases are for a section of land (640 acres) (RX 76m), though others are for tracts ranging in size up to 6,500 acres (RX 76c).

120. The identities of some of the lessees are: Sun Oil Co.; Atlantic Richfield Co.; Kim-Brant Oil Co.; Castile Minerals Corp.; Texaco, Inc.; Border Exploration Co.; Rudman Resources, Inc.; Canada Northwest Oils, Inc.; and Keith Collins Petroleum Corp.

121. As mentioned, certain oil maps were provided by Porter Realty to some customers of GVA (CX 129). The first page of the map, CX 129c,[32] shows an outline of GVA superimposed on a property-ownership map. The second page, CX 129b, shows land ownership between GVA and Van Horn. The map shows that the mineral rights on 18 sections of land south of and surrounding **[32]** Van Horn are owned by Texaco. The first two pages are prominently labeled "West Part of Culberson Co., Texas."

122. The final page of the map, conspicuously labeled "East Part of Culberson Co., Texas," shows land ownership about 50 miles from GVA (CXs 129a; 166N; Watkins 2717–18). Texaco, Continental Oil, Union Oil, and Exxon are shown as owning land or mineral rights in this area. An employee of Texaco confirmed the accuracy of the maps, at least as they related to mineral rights owned by Texaco (Watkins 2749).

123. Notwithstanding the above activity, it was respondents' stated policy not to employ representations concerning oil in their sales approach. As Mr. Kritzler testified (Kritzler 4121):

> Q. What was the policy of the company with respect to sales personnel or brokers making mention of oil in connection with a sales presentation?
>
> A. We called and reprimanded them, and told them that if the complaints continued that we wanted the salesman fired (Kritzler 4121).
>
> Q. Did you, Mr. Gross, or any of the Corporate Respondents, ever authorize the use of that map [CX 129]?
>
> A. No.
>
> Q. When you found out according to the customer that he was given that map, what did you do?
>
> A. Called Porter immediately and told him not to use the map, that it was outside of his jurisdiction to do that (Kritzler 4125).
>
> * * * * * * *
>
> Q. Did you take any action [when you subsequently learned that the map was continued in use by Porter Realty Company]? **[33]**
>
> A. Yes. We told them to absolutely discontinue using the map. I believe that he said he would fire the salesman responsible for doing it, or salesmen for doing it. And that must have been January or February 1978.
>
> Q. What happened after that?
>
> A. Well, after that it came to our knowledge that he was continuing to use it, and that they were continuing to refer to oil in the area, and we terminated him.
>
> * * * * * * *

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[32] The record shows that the pages of the map were out of order when offered into evidence. The proper sequence of pages is CX 129c, CX 129b, CX 129a (Porter 2356–57). The record also shows a map in the proper order (CX 169d–f).

Q. And when you found out that Diversified Realty was using the map did you take any action?

* * * * * * *

A. We told them to absolutely discontinue using it. . . . We terminated them (Kritzler 4126–27).

124. The evidence further shows that respondents' employee Mr. Jeffrey Elfont was assigned to telephone each customer of Diversified Realty and Porter Realty from early 1977 until the brokers were terminated in February and March 1978, respectively (Elfont 4169). After some customers first began referring to oil in late 1977, Elfont questioned each customer whether any statements concerning oil had been made (Elfont 4183, 4194). If a representation had been made about oil, Mr. Elfont made a detailed disclosure to the customer:

From the information that I had received from Mr. Kritzler and Mr. Gross, the nearest oil in production was, I believe, 50 or 60 miles away and that one of the major oil companies owned some land in the vicinity of Green Valley Development and to that point, that was all the information that I had, that there was no current explora-**[34]**tion on the property, nor had there been in the past.

Q. Is that what you informed the customer?

A. Yes.

* * * * * * *

Q. What would be your response to these customers?

A. My response would be absolutely not. We have not, the Company Green Valley Acres has not heard of any development of oil, the development itself, and we don't expect that to happen.

Q. You don't expect what to happen?

A. Any oil development in the area (Elfont 4184–85).

125. Mr. Kritzler further testified (Kritzler 4122):

Q. When a call would be reported to you by Mr. Elfont that oil has been mentioned in the sales presentation, what would you do?

A. I would call the customer and talk to them, and tell them that as far as I knew there was no oil exploration near the property, and that they should not expect to benefit by that, that would be like winning the sweepstakes, chances would be very small that any benefit would come to them (Kritzler 4122; *see also* Kritzler 597).

126. In addition, according to Mr. Kritzler, if it turned out that the customer had purchased the property for its oil-producing potential, the sales contract would be cancelled, and a full refund provided (Kritzler 638–40, 4122–23; Elfont 4186; Porter 2323–24). **[35]**

127. There is an instance in the record of one of consumer witnesses explaining respondents' reaction to an oil-related representation. A representative of Porter Realty allegedly gave the following information to Mr. Swanson:

> Mr. Bauwens in that conversation that this property fronted on a—fronted on a ighway, that there was oil exploration in the area, that again I would get mineral ights to this property, and that there was a potential for return on investment through he mineral rights. . . .I do not recall any representations, in fact, I feel quite sure there vas no representation of any oil wells on the property. It was mentioned that there vere oil wells in the range of 20 or 30 miles away, and that there were explorations n the general area, nearby. (Swanson 2474–75).

Subsequent to this, Mr. Swanson received a telephone call from Mr. Elfont (Swanson 2478). According to the witness, when Mr. Swanson informed Mr. Elfont of the statements concerning oil, Elfont expressed surprise, and said that GVA II was not being sold for its mineral potential (Swanson 2479). Mr. Swanson was subsequently telephoned by Mr. Gross, who offered him a full refund on his property (Swanson 2479–80). Mr. Swanson accepted the offer, and was given a full refund of his money (Swanson 2480).

6. The Situation Concerning Resales

128. The contracts used by the respondents uniformly disclose that respondents would not resell property for their customers. The two SWS contracts in the record, CX 74 and 75, contain the following statement: "The Seller has no program for repurchase and/or resale of lots on behalf of its Purchasers. Purchasers desiring to resell their property would thus offer the property either on their own behalf or through independent real estate agents."

129. The contracts for GVA and GVA II contain a slightly different version of the disclosure: "The Seller, or his agents have no program for repurchase and/or resale of lots on behalf **[36]** of its Purchasers. Purchasers desiring to resell their property would thus offer the property either on their own behalf or through independent real estate agents" (CXs 76, 77, 78).

130. Every customer who discussed resale by a Porter or Diversified sales representative testified to having read and understood the contract (Morley 1381; Limpp 1422; Grygleski 1484;[33] Sweets 1961; E. Smith 2104; Schlachter 2137; Stein 2223; Danskin 2447; Munch 2557–58). No customer testified that he was told or believed that any of the respondents were responsible for reselling his land.

131. On the other hand, numerous witnesses testified concerning the resale activities of the real estate brokers (Switaj 1316; Limpp 1408; Davis 1685; Lueckel 1830; E. Smith 2097; Rawlins 2158; Stein 2211; *see also* Porter 2328).

132. In several instances, there was testimony concerning representations made by employees of Porter Realty after March 1978 (Switaj

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[33] Mr. Grygleski testified that he assumed the Porter salesman would attempt to resell his land for him, but no such statement was made by the sales representative (Grygleski 1477).

1316–17; Davis 1682–87; Lueckel 1830–33; E. Smith 2087, 2106; Stein 2211-14, 2217, 2223; Swanson 2481).

133. The record shows that all relations between the respondents and Porter Realty were terminated in March 1978 (Gross 381; Kritzler 637, 4126; Porter 2244; Elfont 4188). Thus, at the time of the representations referred to above, there was no relationship between respondents and Porter Realty. **[37]**

V. COUNT II

134. Count II of the complaint charges respondents with falsely misrepresenting their properties as suitable for homesites, farms and ranches, because of (par. 13):

(a) The unavailability of, or high cost of obtaining, utilities, water, financing, equipment, improvements and other amenities;

(b) The failure of subdivider respondents to install promised improvements to the subdivisions; and

(c) certain practices of subdivider respondents which substantially impair the ability of purchasers to live on or use their lots.

A. *Representations Concerning Use Of The Properties*

1. Representations Concerning Use As Homesites

135. Respondents admittedly represented to prospective purchasers that the parcels could be used as homesites (RPF 191).[34] But, according to respondents, purchasers were accurately and adequately informed that in order to do so one would have to arrange his own utilities and provide his own residence (RPF 191).

136. As orally argued by respondents' counsel, the land sold in this case was rural undeveloped land in West Texas, 120 miles from El Paso.[35] **[38]**

137. Representations to prospective purchasers concerning homesites were made chiefly in the brochures and fact sheets.[36] Nothing in these documents indicates that respondents undertook responsibility for improving the parcels, same for staking and providing access roads in some, but not all, of the properties (CXs 74–89).

138. Typically, the fact sheets informed purchasers that (CX 85C):

> Piped water is not available to this tract. Buyer may drill his own well. The cost per foot for a drilled and cased well varies, depending on the driller. There is an irrigation well on the property now pumping from approximately 300 feet about 450 gallons per

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[34] Respondents maintain that they did not represent that the southern portion of GVA II was usable as homesites. As noted *supra*, Finding 23, this terrain was of a rugged nature. A buyer was advised that he "would have to inspect his individual parcel to see if it was feasible for building" (RPF 191, n. 51a; CX 84B).

[35] Oral argument, April 14, 1982, pp. 31–32.

[36] I have examined the TV commercials, sales kits, and oral testimony of salesmen and find nothing significantly beyond these representations. The same is evident from the testimony of consumer witnesses.

> inute. The quality of water is good, however, Green Valley Acres, Inc. II makes no arantees, warranty or prediction as to the depth or quality of water on each individu- parcel.
>
> here is no regular in-tract sewer system. However, parcel owners may install septic nks on acreage parcels at an approximate cost of $1,000.00.
>
> lectricity is available at the subdivision. However, extensions of this utility are not ailable to every parcel. Parcel owner must contact the power company for exact costs extending power and initial hookup costs. Address is Rio Grande Electric Co-op., Inc., .O. Box 1137, Marfa, Texas 79843. Approximate cost for extending power is fifty-five ents (55¢) per foot after the first quarter mile, which is free. Full cost of extension is eturned if used up in power during the first five years. Furthest lot is two miles.
>
> here is no in-tract natural gas system. Each parcel owner must contact the various 9] bottled gas companies in Van Horn for charges and hookup information.
>
> elephone] is available at subdivision. Parcel owners should contact the Continental elephone Company; P.O. Box 1510, Pecos, Texas 79772, for the extension and cost of elephone service to his parcel(s).

ee the other fact sheets in evidence for similar disclosures, CX 79, 80, 1, 82, 83, 84.

139. It does not appear to be disputed in this case that the fact sheets vere in widespread use (Gross 344; Kritzler 4107; see Poter 2340). On he face of all contracts, purchasers were required to sign a statement hat they had received and read the fact sheet (CXs 74, 75, 76, 77).[37]

140. Prospective customers were alerted to the existence of the fact heet in the initial telephone call from respondents' broker representatives (CX 122 and 123—"I will mail you a brochure and a fact sheet vhich explains everything in more detail"). When the broker representatives mailed contracts to prospective customers, it was asserted hat the packet always contained a fact sheet and a cover letter recommending that the customer read it (Porter Tr. 2340–43; CXs 126, 264 ("also read the 'Fact Sheet' and sign, signifying that you have done so, on the lower right hand corner of the Agreement")). Customers were also alerted to the fact sheet in the brokers' follow-up call after the documents were mailed. (CXs 124, 125—"Go over the brochure and fact sheet. . . . Initial the box indicating that you did receive the fact sheet").

141. Respondents' own in-house sales personnel uniformly asserted that fact sheets were given to customers as a matter of routine (Hammer 657; Rose 686; Novacy 861, 868; Gelmore 987).

142. Virtually all of complaint counsel's consumer witnesses testified to receiving and reading a fact sheet prior to executing the contract (Baldridge 810; Bear 1155; Switaj 1277; Morley 1344; Limpp 1397; Grygleski 1449; Buck 1507; [40] Allienello 1655; Davis 1675;

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[37] Concerning Mr. Elfont's surveillance calls from February 1977 until April 1958, checking primarily on broker's sales, he testified that virtually all customers he contacted acknowledged receiving a fact sheet (Elfont 4176).

Goldstein 1725; Lambert 1781; Lueckel 1826; Sweets 1949; E. Smith 2067; Schlachter 2116; Stein 2206; Danskin 2425; Swanson 2468; Sowell 2513; Munch 2558).[38]

143. Most consumer witnesses called by complaint counsel either did not testify about development costs beyond stating that they had received and read the fact sheet, or testified that they fully understood that they would have to pay for their own utilities (Goldstein 1719–20; Swanson 2468; Sowell 2508, 2515; Baldridge 810, 815, 817; Danskin 2447). The consumer witnesses called by respondents also evidenced the understanding that they would have to provide their own utilities (Wharton 3569; Muller 3626–27, 3637; Sanchez 3700, 3706; Perkins 4025–26, 4031, 4042; Smallwood 4062, 4078; G. Taylor 4594, 4596–97; W. Taylor 4611; Townsend 4625–27).

144. Respondents' Mr. Kritzler testified that, in his view at least, adequate disclosure was made to prospective purchasers that they would have to bear the expense of improvements (Kritzler 4109–10). Mr. Mitchell of the Van Horn Chamber of Commerce received phone calls from respondents' customers which indicated they knew of their responsibility for these costs (Mitchell 3747).

2. Representations Concerning Farming

145. While no representations concerning crop growing appear in the contracts, the fact sheets represent that "with water and ordinary care, a large variety of grasses, trees, flowers and shrubs may be cultivated. Also, numerous varieties of vegetables may be grown" (CX 81B; *see* CXs 79A, 80A, 82B, 83B).

146. Respondents' descriptive brochures made similar but more detailed representations. CX 86 (used for the first 60 to [41] 90 days of sales of SWS)[39] represented that the Van Horn area had sufficient water and a climate conducive to growing anything which can be raised in California's Imperial Valley, with the exception of citrus fruits. The brochure continues that the growing season is 222 days long and the average temperature is 63 degrees. The soil is described as "rich and fertile." The brochure states that because of the 4,000 foot altitude and arid climate there are few insects and crop diseases. The land can be used for "organic gardening, farming, or orchard development," and an owner can grow "vegetables of all types, grapes, peaches, apples, apricots, pecans as well as grasses and grains." Under the heading "Orchard, organic garden, or farm," the brochure states

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[38] Only two customers who testified questioned whether they received a fact sheet, Messrs. Robinson and Rawlins, even though both had signed the box on the contract indicating receipt. Mr. Robinson's testimony, however, presents credibility problems inasmuch as he testified that he signed the receipt statement, knowing that such statement was *false* (Robinson 1936). Mr. Rawlins' memory appears to have been somewhat faulty. Even so, as an experienced realtor, he indicated his knowledge at the time of purchase that respondents were not to be responsible for improvements to his parcel (Rawlins 2180).

[39] Kritzler 498, 644.

"Imagine raising your own carrots, lettuce, tomatoes, squash, beans, onions, potatoes or fruits." It also states that a fish farm is suitable for five acres (CX 86).

147. An examination of the SWS replacement brochure, CX 87, shows that it is not significantly different from CX 86 in regard to representations about farming or gardening. The brochures for GVA and GVA II, CX 88 and CX 89, are also similar, though they do not contain the reference to fish farms.[40] All four brochures have photographs of nearby farms and produce grown on or near the properties. With the exception of CX 86, which was assertedly prepared by Southwest Land Corporation and only used until new brochures could be printed (*supra,* Finding 66), the photographs are all labelled as to whether they were taken on or near the properties.

148. Respondents' radio and television commercials which were broadcast in Houston, Dallas, and apparently in a few cities elsewhere (Finding 58, *supra*), contain consumer-oriented gardening representations. Some of these advertisements refer to the parcels as "farmettes" (CXs 45, 59, 60). Most of the advertisements, however, simply refer to the quality of the soil and the variety of plants which can be grown (CXs 42, 43, 44, 47, 48, 49, 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 60, 67, 69, 70, 71, 72). One of these commercials discusses the cultivation of crops as follows:

> Own your own farm. You can own your own farmette in West Texas that has five acres [42] of fertile land. It will grow everything except citrus. On this five acres you can grow all the fruit, vegetables, meat and poultry you can eat . . . plus a lot more for sale. . . . It's good, rich soil. . . . You can own this farmette for only $2,995, or as low as $60 down.

CX 60 (first ellipsus in original).

149. The record also contains a number of promotional materials, not of respondents' composition, but which were reproduced by respondents and mailed to customers. Most of these materials are reprints of newspaper articles published in the Van Horn Advocate or other Texas newspapers. There is no allegation nor any evidence that any of the articles were distorted or written by respondents, or that they are untrue (Gross 361). Many of these newspaper articles discuss farming in the Van Horn area. None of the articles refers to respondents' properties or explicitly discusses farming on small parcels.

150. CX 90 basically discusses the onion harvest in Culberson County. CX 91 is an article by a Mr. Murray Cox in the *Dallas Morning News.* The article recounts a visit by Mr. Cox to the Van Horn area.

151. One of the articles reprinted on CX 92 discusses the 1154 acre

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[40] Neither do these brochures contain artists' conceptions of the potential uses of the properties, as set forth in earlier versions of this sales material.

Brookshire pecan orchard located near Van Horn. Pecan growing in the area is also the subject of CX 266. CX 99 is a 1979 newspaper article about an experimental grape vineyard sponsored by the University of Texas. The article states that a goal of the project is to determine if the climate and soil in the Van Horn area are suitable for grape growing. The experimental vineyard is also referred to in the article reprinted on CX 133.

152. The Powell Farm, 8,000 acres with 26 water wells, is the subject of the articles printed in CXs 100 and 101. CX 103, which is based on facts provided by the Van Horn Chamber of Commerce rather than being a newspaper reprint, is also about Powell Farms. The president of the Chamber of Commerce testified concerning the accuracy of CX 103 (Mitchell 3743-45).

153. Some of the same or similar newspaper articles, as well as photographs of neighboring farms, were included in the picture book used by some of respondents' sales personnel (Hammer 663, 673; CX 170).

154. Other written materials which refer to farming and gardening are not significantly different in nature from the [43] ones previously discussed. The record contains various communications to customers or prospective customers by respondents or their representatives, such as letters discussing the fertile soil, good quality water and beneficial climate (CXs 293, 338, 395, 473, 505).

155. In addition to the representations concerning farming found in written materials, the record also contains instances of oral statements made on this subject. Mrs. Baldridge was told via a Dewey Compton commercial that the land was good farm land, but she testified that five acres would be too small to be a real farm, although she believed it suitable for a garden or orchard (Baldridge 806, 821–22). Mrs. Buck was told that on 10 acres in GVA she could grow her own food, and maybe raise a minimal number of cows for home consumption (Buck 1500, 1502, 1506, 1512). Mr. Robinson also was told he could grow his own food (Robinson 1906). Mr. Rawlins was told the land was suitable for home gardening (Rawlings 2149). Others were told that the land was productive (Bear 1118; Morley 1342, 1351; Limpp 1389; Allienello 1624–25; Goldstein 1719–20; Lambert 1781; Lueckel 1823; Sowell 2514).

3. Representations Concerning Ranching

156. Several of respondents' TV and radio advertisements employ the words "ranch" or "ranching" in their text: "fantastic farm and ranch land" CXs 44, 55; "land for ranching" CX 46; "you too can own your own farm, ranch or outdoors retreat" CX 54; "place in the sun to farm, ranch, retire or just do a little hunting or camping" (CXs 57,

395A; *see also* CXs 69, 71). The GVA and GVA II fact sheets list "ranching" as a major industry in the area, and the brochures for these properties carry a picture of grazing cattle (CXs 83D, 84D, 88D, 89K).

157. If I properly understand complaint counsel's position, it is to the effect that these representations amount to purchasers being told that they could successfully operate a commercial ranch on 5 to 40 acres of respondents' properties (CPF, p. 108).

158. I cannot so interpret these statements. Rather, from other such advertisements in the record it is abundantly clear that what respondents are saying is that it is possible to raise enough beef on the land to feed one's self or one's family: "or raise livestock and put beefsteak back in your food budget" (CXs 47, 50; "raise beef on it and have enough of everything for your own table" CX 51; *see also* CX 48). According to Mr. Gross, this was the intendment of respondents' representations **[44]** concerning ranching, the witness conceding that commercial ranching on the parcels was not practicable (Gross 422–24; *see also* Kritzler 635).[41]

B. *The Parcels Are Usable As Homesites*

1. Utilities

159. Although the complaint apparently speaks in terms of the unavailability of utilities, as well as their high cost, that issue, as we shall see, is not really present in this case. The issue as to utilities is therefore limited to whether the obtaining of them would entail such high costs, that the use of the parcels as homesites would be as a practical matter rendered nil. We shall examine electricity, telephone, sewage disposal and gas.

a. *Electricity*

160. In the fact sheets, the following disclosures are made concerning electricity:

> ELECTRICITY—Electricity is available at the Subdivision. However, parcel owner must contact the power company for exact costs of extending power and initial hookup costs. Address is Rio Grande Electric Co-op, Inc., P.O. Box 125, Bracketville, TX 78832 (CXs 81C, 82C).

> ELECTRICITY—Electricity is available at the Subdivision. However, extensions of this utility are not available to every parcel. Parcel owner must contact the power company for exact costs of extending power and initial hookup costs. Address is Rio Grande Electric Co-op, **[45]** Inc., P.O. Box 1137, Marfa, TX 79843. Approximate cost for extending power is fifty-five cents per foot after the first quarter mile, which is free. Full cost

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[41] The witness Mrs. Buck was informed by respondents' salesman that it would be possible for her to raise her own beef (Buck 1503).

of extension is returned if used up in power use during the first five years. Furthest lot is two miles (CX 83C, 85C).

ELECTRICITY—Parcel owner must contact the power company for exact costs of extending power and initial hookup costs. Address is Rio Grande Electric Co-op, Inc., P.O. Box 1137, Marfa, TX 79843. Approximate cost for extending power is fifty-five cents (55¢) per foot after the first quarter mile, which is free. Full cost of extension is returned if used in power use during the first five years (CX 85C).

161. Mr. Richard Gwartney, the General Manager of the Rio Grande Electric Cooperative, Inc. (the "Co-op") testified in this proceeding (Gwartney 1184–1218). The Co-op serves approximately 45,000 square miles of rural Southwest Texas. This encompasses all of the rural areas lying beyond a two mile radius of the town of Van Horn, including SWS, GVA, and GVA II[42] (Gwartney 1185–86).

162. Mr. Gwartney testified that the policy of the Co-op is to give a free electric line extension to new customers of up to one quarter mile for each electric meter installed (Gwartney 1201, 1205). The only cost within this distance is a connection fee and a membership fee in the Co-op of about $20 (Gwartney 1205).

163. Accordingly, if a customer's operation required two meters, he would be given a free half mile extension. If three, then three quarters of a mile (Gwartney 1215–16).

164. In 1979, the cost of installation of single-phase (residential use) electric service was 75 cents per foot, or $3,960 a mile from existing power lines. The cost of installation of three-phase electric service (irrigation or other commercial use) was $1.10 per foot, or $5,808 per mile [**46**] from existing power lines. The costs of installation would have to be paid prior to installation (Gwartney 1203–04). Installation costs as of April 1981 for single-phase service were $1.20 a foot, or $6,336 per mile; and the cost of three-phase installation were $1.70 a foot, or $8,976 per mile from existing power lines (Gwartney 1205).

165. This cost is offset against the customer's monthly electric bills until the full cost has been refunded to the customer within a scheduled time period (Gwartney 1201–02; *see* CXs 434, 484). Additional customers who tie into a line extension increase the rate of repayment of the original line extension cost (CXs 434, 484).

166. The record shows that there are electric lines in and near each of the three properties. Photographs show various lines crossing the properties (CXs 88I; 89J; CX 153D, E, G, H, I, J; 436, photograph pages 3, 4, 8, 10, 11, 17; RX 43, 46, 48). Many parcels are relatively close to existing lines (W.D. Smith 977; Gilmore 1015–18; *see* CXs 485; 486). There are, however, some parcels that are as much as two or three miles away (M.D. Smith 977; Gilmore 1018).

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[42] Most urban areas are served by investor owned utilities (Gwartney 1186).

167. One of respondents' salesmen testified that sales representatives basically knew where the existing electric lines were located, and would sell a lot within the free extension distance if the customer planned on using his parcel (Novaez 895). Any customer visiting the property was able to see where the electric lines were located. Thus, Mr. Wharton was able to discover the location of electric lines when he purchased onsite, and obtained electric service for a total cost of $136.00 (Wharton 3572).

168. Respondents' contracts all permit purchasers to exchange their parcels for other available locations (CXs 74A, 75B, 76A-B, 77A-B, 78A-B). This is apparently not a complicated procedure, if the experience of witness Edward Muller is typical, who traded his property to obtain low-cost electrical service (Muller 3627–28). In fact, this witness had traded his property three times, obtaining approval from respondents' California headquarters by telephone (Muller 3633–35).

169. It is also possible that by the time a purchaser is ready to use his parcel, an electric line will have been extended in his direction. Thus, there is the testimony of Mr. Perkins that he was originally informed that the line extension to his parcel would cost $700. However, by the time he requested service, the line had already been extended to a tract within a quarter mile of his parcel. His line extension, therefore, is without extension costs (Perkins 4031–32). **[47]**

170. There is no testimony in the record that the cost of obtaining electricity had dissuaded any purchaser from using his property.[43]

b. *Telephone*

171. Prospective purchasers are informed in respondents' fact sheets that telephone service is available, and they are advised to contact the telephone company for information concerning the extension and cost of telephone service to their parcels (CXs 80B, 81C, 82C, 83C, 84C, 85C).

172. The record contains the testimony of Mr. Ronald Ethridge, an employee of Continental Telephone Service Corporation (Ethridge 2763–94). From 1976 until 1981, he worked in Pecos, Texas, as Customer Service Manager. His service area included the Van Horn area, and that of the subject properties (Ethridge 2764–65).

173. The costs associated with telephone service in the rural areas where the properties were located included installation charges totaling $55; a monthly service charge of $7.60 plus $1 per airline quarter mile from Van Horn for a private line, or $7.80 for a four-party line; and a line extension charge (Ethridge 2770–71). The latter worked on the principal that Continental would extend telephone lines free of

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[43] There was testimony that bottled gas could be used as an effective substitute for electricity to serve most needs (Harris 3024).

charge to rural users if they were within 1/2 mile of existing lines. If they lived farther away the charge would be, after the first 1/2 mile, fifty cents a foot (Ethridge 2777–78).

174. The existing lines of SWS are as follows:

> On CX 87E, F, and G, a line parallel to Interstate 10 on the southern most boundary of SWS units 200, 202, 203, 204, 207, 212, 217, and 231. Additionally, the line extends for 1/2 mile on the eastern most boundary of unit 200. (Ethridge 2779–81). **[48]**

175. The existing lines on GVA are as follows:

> On CX 88, in a line parallel to Highway 90, along Farm to Market Road 1929 in a southerly direction to a point between the southwestern portion of limit 34 and the southeastern portion of Unit 27 (Ethridge 2787).

176. The cost of extending telephone lines can be considerable. Mr. Ethridge placed the cost of a five-mile extension at $11,880 (Ethridge 2784–85). Mrs. Buck, for example, considered getting a phone but due to the fact that her lot was approximately two miles from the closest telephone lines, it "would cost too many thousands of dollars" to install a telephone (Buck 1521). Indeed, to extend telephone lines to Unit 13 of GVA from existing lines would cost a minimum of $6,600 (Ethridge 2788).

c. *Sewage Disposal*

177. Prospective purchasers are informed in the fact sheets that there is no central sewage system at the properties, and that sewage disposal is by individual septic tank. The later fact sheets estimated the cost of a septic tank including installation, to be $1,000 (CXs 83C, 84C, 85C).[44]

178. There is scanty evidence in the record regarding sewage or waste disposal. There was testimony that Mrs. Buck's septic tank cost $790 in 1978 (Buck 1520). However, Mrs. Buck claimed she was told by Mr. W.D. Smith, respondents' then on-site representative, that a septic tank could probably be put in for less than $100 (Buck 1512).

179. One purchaser, Mr. Wharton described how he constructed his own septic tank, working from scratch, for a cost of approximately $20 (Wharton 3570). **[49]**

d. *Natural Gas And Propane*

180. Texas Western Municipal Gas Company, located in Van Horn, Texas, distributes natural gas to the city of Van Horn and the Wildhorse and Lobo Valley farming areas (Beasley 2845). There are no other companies that provide natural gas service in this area (Beasley

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[44] Earlier fact sheets had placed this cost at $500 (CXs 80B, 81C, 82C).

2846). Texas Western Municipal Gas Company's service area includes SWS, GVA and GVA II, but there are no company natural gas pipelines on the subject properties at this time (Beasley 2847). Some SWS property may be located as far as four to five miles from the company's existing pipelines (Beasley 2855). Some GVA property may be as much as seven miles from the company's existing pipelines (Beasley 2856, 2862). Some GVA II property may be as much as five miles from the company's existing pipelines (Beasley 2857, 2862).

181. The cost of obtaining residential natural gas service from the company includes a $120 hot tap fee which involves tapping into the main transmission pipeline (Beasley 2847); pipeline costs of 42 cents per foot for the smallest PVC pipe available (1 inch); 25 cents per foot for ditching (digging the trench in which to lay the pipe); $400 for labor; and $250 for backfill (refilling the trench) (Beasley 2848–50). Therefore, total cost for installation of residential natural gas service would be approximately $5000 per mile (Beasley 2850). A $50 deposit is also required (Beasley 2848).

182. The cost of obtaining natural gas service for commercial use, *e.g.*, irrigation, using the smallest pipe size (1–1/4 inch) would increase installation costs by 20 cents per foot (Beasley 2851). Therefore, the cost for commercial installation would be approximately $6000 per mile.

183. Texas Western Municipal Gas Company has never installed a natural gas pipeline for irrigation purposes on a 5–acre, 10–acre or 20–acre tract of land in this area (Beasley 2852). Most commercial irrigation systems serviced by the company utilize at least eight inch pipe, capable of irrigating 80–100 acres (Beasley 2853).

184. Average monthly cost for natural gas service can be as high as $50 for residential use, and can range from $10,000 to $105,000 for commercial irrigation use (Beasley 2864).

185. The record shows that a practical alternative to natural gas service is propane.[45] In this connection, **[50]** prospective purchasers were advised on all fact sheets that natural gas systems were not available at the properties, and that each parcel owner must accordingly contact the various bottled gas companies in Van Horn for charges and hook-up information (CXs 79B, 80B, 81C, 82C, 83C, 84C, 85C).

186. Witness Charles Harris, Manager, testified that the Kettle Oil Company distributed liquid petroleum gas (propane) to homes, farms, and ranches in the Van Horn, Texas, area, approximately fifty miles in each direction from Van Horn (Harris 3017).

187. Installation costs for propane gas include $350 for a 150 gallon tank (the smallest available), and $70 for labor and parts (Harris

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[45] The record contains some reference to butane, but the context is not clear (Harris 3017).

3018). However, outside of the city, a 250 gallon tank is recommended because delivery is limited to once a month. This tank sells for $460, plus the above installation costs (Harris 3018). The purchase of a commercial propane system ranges from $975 to $990 for a 100 gallon tank, including installation (Harris 3020); to $989 for a 1,000 gallon tank, plus installation charges of $450–500 (Harris 3021–21). The cost of propane gas is 65.9 cents per gallon or $220 to fill a 250 gallon tank (Harris 3023).

188. Kettle Oil Co. is presently providing propane gas to four families living on SWS property, and to three families living on GVA property (Harris 3022).

2. Water Availability And Cost

a. *Availability Of Water*

i. The Claims

189. There is no dispute that respondents represented that water was readily available on their properties in far West Texas.

190. Television advertisements and brochures spoke of "virtually unlimited water" and a "virtual ocean of water" (CXs 44, 47, 50, 52, 54, 56, 69, 70, 86–87).

191. Another TV commercial refers to "[a]n enormous underground water supply very close to the surface . . . just waiting to be tapped" (CX 43).

192. An SWS fact sheet places the water table under that property at between 250–400 feet (CX 79B). A GVA fact sheet **[51]** refers to an irrigation well on the property pumping from about 220 feet underground at 450 gallons per minute ["gpm"] (CX 83C). A GVA II fact sheet refers to an irrigation well pumping from approximately 300 feet at 450 gpm (CX 85C).

193. CX 103, "An Information Sheet for Texas Property Owners" disseminated by respondents, claims that the drilling of new wells has not caused a decrease in the water table:

> The Powell Farm now has 26 wells about 1300 feet deep. The water rises to about 300 feet, the level from which they pump. Each well delivers an amazing 2200 gallons per minute. According to Mr. M.J. Mitchell, President of the Chamber of Commerce, this tremendous flow of water has not lowered the water table.

194. Purchasers testified that they were told by sales personnel that "[t]here was plenty of water available" (Lambert 1782), or that "[w]ater was abundant in the area" (Swanson 2463). Dr. Danskin testified that he was told that "this property was really quite valuable and the aspect that water is very hard to come by in Texas and that

the property had 'large pools of sweet water' readily available beneath the property" (Danskin 2423; see also Morley 1348).

195. Other purchasers testified that they were told the water on their property was "pretty shallow, below the surface" (Baldridge 818); 150 feet below (Robinson 1912); 200 feet below and good quality (Munch 2524); 240 feet from the surface (Buck 1501, 1558).

ii. The Actual Availability Of Water On The Properties

1. *Availability Of Water On SWS*

196. In September 1980, the Texas Department of Water Resources published a report entitled "Availability of Fresh and Slightly Saline Ground Water in the Basins of Westernmost Texas" (RX 67). The report recites that it was prepared by the U.S. Geological Survey under cooperative agreement with the Texas Department of Water Resources. Figures 7 and 9 of this report **[52]** show that SWS is located within an area containing "significant amounts" of fresh and slightly saline water. Figure 8 of the report shows wells throughout SWS and the surrounding area.[46]

197. In 1972, respondents first became interested in purchasing SWS (Kritzler 4901). Mr. Kritzler testified that he met with Mr. William Bray, then a vice president of Southwest Land Corporation, to learn of the characteristics and quality of the land in SWS. One of respondents' primary concerns was the amount and quality of water (Kritzler 4091). Mr. Bray at that time reportedly had an understanding of these matters (W. Bray 3774).

198. Southwest Land Corporation was in possession of a hydrology report on the property dated March 1968, which had been prepared for Mr. Hugh Wolfe[47] by Mr. Ed Reed, an hydrologist in Midland, Texas (W. Bray 3775). According to the testimony, this report, in evidence as CX 372, was given to Mr. Kritzler (Kritzler 4091-92; W. Bray 3775).

199. Mr. Kritzler interpreted the report as showing water to be "very valuable in the area" (Kritzler 4092). The report states as follows (CX 372 at 6):

> Ground water under the lands in question occurs in two reservoirs; the Quaternary alluvial section, and the Permian Reed section. . . . Static water levels in alluvial wells have been measured at depths ranging from about 230 feet to 290 feet below the land surface. Thus saturated thicknesses up to about 450 feet can be expected. . . . [I]t is

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[46] SWS is not explicitly shown on Figures 7, 8 and 9 of RX 67. Its location can be estimated with a sufficient degree of accuracy. RX 49 shows that the extreme southwest corner of SWS is marked by a diagonal dirt road. The same road is shown on Figures 7, 8 and 9. The southeastern corner of SWS is near where Plateau Draw intersects the railroad line, easily visible on Figures 7, 8 and 9. Wells number 161 and 162 on RX 49 (just southeast of the southeast corner of SWS) correspond with the two wells straddling Route 10 on Figure 9.

[47] Mr. Wolfe had been a previous owner of the land which ultimately became SWS (Wolfe 4549-50).

estimated [53] that well yields of the order of 800 to 1500 gallons per minute can be expected.

200. It was Mr. Reed's preliminary estimate that the alluvial aquifer under SWS property could yield 15,000 acre feet of water per year for 74 years, or a total of 1,110,000 acre feet of water (CX 372 at 9).

201. The second reservoir noted by Reed in the report is in the Permian Reef, Capitan Reef and dolomites (CX 372 at 4–6). This reservoir is in the eastern portion of SWS. The report states that there is "an excellent possibility of developing substantial volumes of water from the reef dolomites present in this area" (CX 372 at 6).

202. A second report covering the SWS land was prepared by Mr. Reed in April 1969 for C.B.K. Industries (CX 373). The findings in this report were consistent with, but slightly different from, the findings in the earlier report. This document reported static water levels ranging from 225 to 325 feet (CX 373 at 6). The total reserves found were 628,227 acre feet (CX 373 at 6), with annual recharge of 7,200 acre feet (CX 373 at 7). The discrepancy between these total reserves and the reserves found in the earlier report was explained on the basis that the earlier report covered a larger parcel of land (CX 373 at 7–8).[48] Promotional materials used by respondents used the more conservative estimate of reserves (*See* CX 87B).

203. A third report, CX 205, was prepared in November 1977 (Reed 2599). There was testimony that this report found static levels of approximately 250 to 280, 290 feet below land surface in the alluvium (Reed 2633).[49]

204. Mr. Joseph Reed, the son of Mr. Ed Reed, prepared the third report and testified as an expert hydrologist in this proceeding (Reed 2586–2667). He gave an explanation of the three reports. It seems undisputed that there are two aquifers [54] in SWS. The limestone aquifer is the deeper of the two and covers the entire property. The alluvium aquifer is on top of the limestone aquifer and covers the western one half to two-thirds of SWS (Reed 2625). The alluvium aquifer is as much as 900 feet thick, and a well any place in this aquifer will strike water at approximately the same depth (Reed 2633, 2649).[50]

205. The major difference between the alluvium aquifer and the limestone aquifer is that although there is water in the limestone, it

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[48] The record does not explain the difference in sizes. There is evidence that SWS was originally 20,000 acres, and that 2,000 acres were sold in bulk to an investor from Chicago (Lara 3884; Wolfe 4549–50, 4552–53).

[49] This report, although referred to in the testimony as CX 205, and so cited to me by counsel is nevertheless listed as missing from the evidentiary record. An earlier draft which is in the record placed static water levels at from 177 to 384 feet, and well yields from 300 to 1,500 gpm (CX 528E).

[50] An alluvium aquifer is made of sand and gravel with water in the spaces between the solids. The water naturally seeks a constant level. The difference in static water levels is caused by the varying topography of the surface of the ground; the surface of the water table is relatively constant.

may be possible not to find water in any specific location, because the limestone is less porous than the alluvium (Reed 2649).

206. However, witnesses familiar with the area testified that to their knowledge no driller has failed to find water in any well in the limestone in or near SWS (Gilmore 3975; Wolfe 4543–45, 4550, 4558; *see* W. Bray 3832).

207. Additional witnesses confirmed that, irrespective of any possibility of not finding water in any particular location in the limestone aquifer, actual experience has shown water to be available throughout the limestone area (Holtz 3068; Gunter 2881–83; Harlow 2953; Mitchell 3720). As stated by one local well driller, although it is possible that water may not be found in a well in the limestone area, water will generally be found there (Stanton 3146).[51]

208. The first Reed report states there is "an excellent possibility" of finding "substantial" amounts of water in the limestone aquifer (CX 372 at 6). Mr. Brooks, respondents' appraisal expert, testified "based upon hydrology studies prepared in the area there are overwhelming indications that both the quality and quantity of water were sufficient and they were in the area" (Brooks 4458).

209. According to Mr. Reed, there is a well in the limestone just north of SWS which produces water at a depth of about 600 feet (Reed 2635). The maps prepared by Mr. Ramon Lara show numerous wells in the limestone area in and adjacent to SWS **[55]** (*See* RX 49C; Lara 3907–12). RX 68, another U.S.G.S. report published in cooperation with the Texas Department of Water Resources, shows a multitude of wells throughout the area of SWS, including the area over only the limestone aquifer (RX 68 at Figure 3 and pages 28–38).

210. Mr. Compere, the appraisal expert who testified for complaint counsel, was of the view, based upon expert consensus, that there was a plentiful supply of good water available in SWS (Compere 3479–80).

211. There was testimony that where water is found in the limestone, well yields are likely to be higher than from those in the alluvium (Reed 2646). The Powell Farm, immediately west of SWS, has large capacity irrigation wells which pass through the alluvium aquifer and draw water from the limestone (Reed 2631; Mitchell 3745; CX 103).

2. *Quality of SWS Water*

212. Complaint counsel contend that water found on SWS property exceeds certain water quality limits (CPF 129).

213. The Environmental Protection Agency ("EPA") has promulgated regulations under the Safe Drinking Water Act, Pub. L. 93–523 (1974), establishing maximum safe contaminant levels for drinking

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[51] "You don't get it every time but it is a pretty good percentage chance that you will get it" (Stanton 3146).

water. 40 C.F.R. 141. No maximum level is established for total dissolved solids. 40 C.F.R. 141.11. A second set of regulations control "contaminants in drinking water that primarily affect the aesthetic qualities relating to the public acceptance of drinking water." 40 C.F.R. 143.1. It is these regulations that set a limit on total dissolved solids which allegedly is exceeded by some of the water available in some areas of SWS. 40 C.F.R. 143.3.

214. However, the two U.S.G.S. reports in the record, RX 67 and RX 68, demonstrate that slightly saline water is usable for all purposes, notwithstanding that it exceeds EPA recommended limits (RX 67 at 39–40). Figure 9 in RX 67, for example, shows that more than half the wells in Wild Horse and Michigan Flats tap slightly saline water rather than fresh water. But there is no showing that such water is thereby unusable.[52] **[56]**

215. The second U.S.G.S. report, RX 68, shows that the wells in the "slightly saline" areas of SWS and the surrounding areas which exceed EPA recommended limits are used for domestic, irrigation, public supply and livestock purposes. An example is given below, taken from RPF 274, n. 72.[53]

216. The Reed report prepared for Hugh Wolfe and given to respondents at the time they purchased SWS, states that the water in the alluvium section is of "good to excellent quality" (CX 372 at 8). The limestone water is found to be of lesser quality, having total dissolved solids in the range of 660 and 690 parts per million (Reed 2643–44; CX 372 at 9).

217. The second Reed report, also prepared prior to respondents' purchase of SWS, states that total dissolved solids are in the range of 71 to 342 milligrams per liter, again within the EPA aesthetic limits (CX 373 at 7). The report states "The quality of water obtained from the test holes is generally better than that found to the north and equal to or better than alluvial water to the northwest" (CX 373 at 7).

218. Not until November 1977 did a Reed report cast doubt on the quality of water in some portions of SWS (*see* earlier draft, CX 528H, I). Even this report, which uses terms like "high salinity hazard," makes it clear that the water is still usable for all purposes so long

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[52] Slightly saline water is usable for all purposes, as is demonstrated by the fact, for example, that most of the wells shown on Figure 7 or RX 67 are in areas with slightly saline water.

[53] There is a well on Route 10 just east of SWS, shown as well 161 on RX 49. Figure 3 of RX 68 shows well #601 near where Plateau Draw intersects Route 10. (Pages 1-2 of RX 68 explain the well numbering system.) This is the same well as 161 on RX 49. It is in the limestone area, and is shown in Figure 9 of RX 67 to be in an area with slightly saline water. A full chemical analysis of this well is given on page 89 of RX 68; it is the 11th well from the top of the page. The analysis shows that the water contains more than 1,000 milligrams per liter of dissolved solids; *i.e.*, it is slightly saline and it exceeds the EPA recommended limits. On page 37 of RX 68, the same well is discussed in more detail. It is the 12th well on that page. The chart shows that water is obtained at a depth of 587–95 feet from the limestone aquifer. It is used to supply a house and a service station. The use code for the well is D, which is defined on page 19 as denoting domestic use.

s certain practices are followed. For example, the report states that vater with a high sodium hazard can be used for "extensive irrigation or long periods of time" if gypsum and, perhaps, limestone are added o the soil (CX 528H, I). **[57]**

219. In his testimony Mr. Reed explained the statements in the 1977 vater report concerning quality. He apparently believed that the vells he tested within SWS have water within recommended quality imits (Reed 2642–44). There is one well, however, just to the north of WS which exceeds the recommended limits (Reed 2644). This water an be used for irrigation, consumption by animals, or any other urpose (Reed 2644). In addition, because the quality limits are merey recommended for aesthetic purposes, the water can also be used for uman consumption, as similar water is used in many areas throughut the southwest (Reed 2662). Many cities have municipal water vhich exceeds recommended limits, and use such water on a regular asis (Reed 2663). Finally, Mr. Reed testified that water can easily and inexpensively be filtered using in-home filtration devices currently on he market (Reed 2662–63).

3. *Availablity Of Water In GVA*

220. There appears to be no dispute as to the good quality of water in GVA (*See* CX 374; Buck 1566; Holtz 3094; Compere 3480; Brooks 4458).

221. The only issue with respect to the water in GVA is whether the quantity is sufficient. The only evidence which raises doubts concerning the sufficiency of water in GVA arises from a preliminary report prepared by an employee of Ed L. Reed & Associates (CX 374). The cover letter to the report states that "the water quality is good, but the quantity of water which may be available appears to be low."

222. Mr. Reed was instructed by the respondents to "give a preliminary look" at the ground water in GVA in 1976 (Reed 2610). A preliminary report is one that is based solely on readily obtainable public information (Reed 2612–13). A preliminary report does not involve any test drilling, or other collection of non-public data (Reed 2612). The GVA preliminary report was based upon measurement of a few existing wells, a review of U.S.G.S. topographic maps, and some analysis of water samples (Reed 2613). CX 374K shows that only seven wells were reviewed in making the preliminary report.

223. Mr. Joseph Reed testified that at the time of the preliminary study there were three reasons for expressing caution about the quantity of water in GVA: (1) windmill wells were pumping only two to ten gallons per minute, (2) an irrigation well on the property was abandoned because it produced insufficient water for irrigation, and (3) the aquifer appeared discontinuous from the major aquifer to the east **[58]**

(Reed 2617). Later information casts doubt upon Mr. Reed's three reasons for expressing caution.

224. The amount of water produced by a well is determined in large part by the diameter of the well and the size of the pump (Gilmore 3957; Stanton 3150–54). According to witness Gilmore, a windmill, the least powerful pump available, is only intended to produce up to ten gallons per minute with a four inch diameter well (Gilmore 3957–58). Thus, the fact that windmill wells in GVA produced only 10 gpm does not prove that the available quantity of water is low. A larger well or more powerful pump could produce more water from the same location.

225. A pump jack, similar to a windmill but with a 1.5 horsepower motor, produces 10 to 15 gallons per minute (Gilmore 3956). A larger pump in the same well will increase the yield of the well (Gilmore 3957).[54] According to Mr. Gilmore, one resident of GVA replaced his windmill with a three horsepower pump and increased the yield to 20 gpm (Gilmore 3958–59). One of complaint counsel's purchaser witnesses had a well drilled in GVA in 1978, two years after Reed's preliminary report. The well has an electric pump rather than a windmill and produces substantial quantities of water (Buck 1519). A well driller in Marfa estimated that a well in GVA would produce 100 gpm (G. Taylor 4596). Thus, the fact that the windmills in 1976 were producing only 2 to 10 gpm may not be significant.

226. The second reason given by Mr. Reed is the abandoned irrigation well in the northern part of the property (Reed 2616–17). The map at CX 374K shows that the witness considered four wells in the northern part of the property, labelled W–5, 609, King and 606. W–5 is described at CX 374I as "windmill—down, broken rod." Thus, this is not shown to be an irrigation well, nor abandoned because of insufficient water.

227. The second well is labelled 609. It can be located at RX 68, Figure 4, bearing the code number 51–10–609.[55] This **[59]** well is the first well discussed in the chart on page 57 of RX 68. It shows that the well discharged 805, 640 and 760 gpm in 1966, 1968 and 1973, respectively. The well apparently was never abandoned, and thus cannot be the well referred to in Mr. Reed's testimony.

228. The King well is the first one listed on CX 374I. It is described as producing 400 gpm from 218 feet. Again, there is no indication that it is abandoned, and so it cannot be the well referred to.

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[54] Gilmore gave one example from the company-owned property in SWS. With a 10 horsepower pump the well produced 65 gpm. With a 25 horsepower pump the same well produced 180 gpm. With two 25 horsepower pumps the well produced 300 gpm (Gilmore 3957).

[55] The 51 refers to the entire area covered by Figure 4. *See* upper left corner of Figure 4. The 10 refers to the quadrangle covering GVA, also numbered in the upper left corner. Six hundred nine is the number of the well within quadrangle 10. The well numbering system is explained in detail at RX 68, pages 1-2.

229. The final well considered is 606. The description given of it on CX 374I is not understandable without an explanation by a witness. The well, however, can be located on RX 68, Figure 4, with the number 51-10-606. The chart on page 56 indicates that this is an irrigation well drilled in 1950, which corresponds to Mr. Reed's recollection that the well he referred to is an irrigation well drilled in 1949 (Reed 2616-17). The chart also shows that the well was abandoned. This must, therefore, be the one Mr. Reed described as having been abandoned because of insufficient water. However, RX 68, which was published four years after Reed's report, shows a different reason for the abandonment of the well. The chart at page 56 states "Discharged 690 gal/min 3-11-73; obstruction at 120 feet in 1973." In short, Mr. Reed was simply probably incorrect in describing the reason the well was abandoned. None of the wells in the area of GVA has been shown to be abandoned because of insufficient water.

230. The third reason given by Mr. Reed was admittedly speculative. He found a discrepancy in water depths in the Lobo Valley wells, and concluded that there may be two separate aquifers (Reed 2619). However, "this was a question that we didn't resolve in the report" (Reed 2620). Rather, Mr. Reed reported to respondents "further testing would be required to properly evaluate the yield of the aquifer" (CX 374A).

231. Here, also, Mr. Reed's speculation was apparently mistaken. RX 67, the U.S.G.S. report published four years after Mr. Reed's preliminary report, has maps of the Lobo Valley aquifer at Figures 11 and 13. Neither of these maps suggests discontinuous aquifers. Nor does the text, RX 67 at 45-54, suggest separate aquifers. **[60]**

232. In addition to the above, Figure 11 of RX 67 describes the area of GVA as an "area containing significant amounts of fresh water." Elsewhere, the same report indicates 1,500 feet of potentially permiable material in GVA; that is, it indicates that GVA is over a 1,500 foot thick aquifer which may contain significant quantities of water (Reed 2621-23). Mr. Reed testified that he could not fully interpret the meaning of this finding without seeing the results of pumping tests (Reed 2622-23).

233. An expert report by a Dr. Sam Little, offered by complaint counsel, concludes that "an ample supply of excellent quality water is there for any reasonable period of time in the foreseeable future" (CX 220B).

234. Since 1976, several residents of GVA have drilled wells and found substantial amounts of water (Buck 1519; Gilmore 3958-59; W.D. Smith 928; Sanchez 3690; Taylor 4597). (Taylor has not yet drilled his well, but a neighbor's well less than one quarter mile away produces sufficient water from a depth of 450 feet to irrigate 1,280

acres.) One well, located in Unit 7 of GVA, yields over 1,000 gpm (W.D. Smith 948). There are now at least 11 wells in GVA and GVA II (W.D. Smith 971; Drew 762). No witness with actual experience with a well in or near GVA testified that there was insufficient water for domestic or agricultural use.

235. The final major reason not to rely upon Mr. Reed's preliminary report is that it is countered by the large number of wells in and near GVA (W.D. Smith 927). CX 529, the map given to Mr. Reed outlining GVA, shows about 30 wells in or near GVA. RX 67 at Figure 13 shows more wells than can be conveniently counted in the area of GVA, as does Figure 4 of RX 68. Figure 11 of RX 67 shows GVA in the middle of an area labelled "area containing significant amounts of fresh water." The map prepared by Ramon Lara, RX 50, shows at least 115 wells in and near GVA. It also shows that GVA is in the midst of a heavily irrigated agricultural area. *See also* RXs 28, 39, and 43.

4. *Availability Of Water In GVA II*

236. There was testimony that the southern portion of GVA II was never sold or available for sale, except in isolated instances of sales to hunters and campers (Kritzler 4099). The presence or absence of water in that area is not therefore an important issue, and complaint counsel did not offer any **[61]** evidence related to the availability of water in GVA II.[56] However, the maps in RXs 67, 68, and 50 cover that area, and show it to be within the Lobo Valley aquifer and in close proximity to numerous wells.

237. As to the northern half of GVA II, even the preliminary Reed report, CX 374, indicates that the western boundary of the major source of water is several miles to the west of GVA II. Mr. Reed suggested that the western boundary of the major aquifer is FM 1523, CX 374C, which is several miles west of GVA II (RX 50). Thus, GVA II is in the area Reed found to have plenty of water at shallow depths.

b. *Cost Of Drilling Wells*

238. In connection with obtaining water for use on the properties, respondents have disclosed the following information with regard to water on SWS (CX 79A-B):

> Piped water is not available to this tract. However, each Buyer may drill his own well. The cost per foot for a drilled and cased well varies, depending upon the driller. The water table will run from approximately 250 to 400 feet. A complete Hydrologist Report for the total property is available upon written request. Individual information may be obtained by property owners by contacting the author of the Hydrologists Report.

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[56] Mr. Reed's preliminary report on GVA did not include GVA II (CX 529). GVA Inc. II was not yet in existence in 1976 when the GVA preliminary report was compiled.

239. And CX 80A states:

> Piped water is not available to this tract. However, each Buyer may drill his own well. The cost per foot for a drilled and cased well varies, depending upon the driller. A complete Hydrologist Report for the total property is available upon written request. [62] Individual information may be obtained by property owners by contacting the author of the Hydrologists Report.

240. Similarly CX 81B states:

> Piped water is not available to this tract. However, each Buyer may drill his own well. The cost per foot for a drilled and cased well varies, depending upon the driller and water table. A complete Hydrologist Report for the total property is available upon written request. Individual information may be obtained by property owners by contacting the author of the Hydrologists Report.

241. With regard to GVA, the fact sheet states (CX 83C):

> *WATER:* Piped water is not available to this tract. However, each Buyer may drill his own well. The cost per foot for a drilled and cased well varies, depending upon the driller. There is an irrigation well on the property now pumping from approximately 220 feet at about 450 gallons per minute. The quality of water is good, however, Green Valley Acres, Inc. makes no guarantees, or warranty or prediction as to the depth or quality of water on each individual parcel.

242. With regard to the northern portion of GVA II, the fact sheet states (CX 85C):

> *WATER AND MINERAL:* Seller's water rights are being conveyed to all Property owners. Piped water is not available to this tract. Buyer may drill his own well. The cost per foot for a drilled and cased well varies, depending upon the driller. There is an irrigation well on the property now pumping from approximately 300 feet about 450 gallons per minute. The quality of water is good, however, Green Valley **[63]** Acres, Inc. II makes no guarantees, warranty, or prediction as to the depth or quality of water on each individual parcel.

243. With regard to the southern portion of GVA II, the following information is disclosed in the fact sheet (CX 84B):

> *WATER AND MINERALS:* Seller's water rights are being conveyed to all property owners. Piped water is not available to this tract. However, each Buyer may drill his own well. The cost per foot for a drilled and cased well varies, depending upon the driller. Green Valley Acres, Inc. II makes no guarantees, warranty, or prediction as to the depth or quality of water on each individual parcel.

244. Mr. Harlan Stanton testified regarding the costs of drilling a well. Mr. Stanton, a licensed well driller in Texas, had been the owner of a drilling company for eighteen years. He had been engaged in drilling for water since 1950, all of such drilling having taken place

within 150 miles of Pecos, Texas, which is 90 miles from Van Horn (Stanton 3135–37). Mr. Stanton has drilled water wells in Culberson and Jeff Davis counties and in the Van Horn area (Stanton 3137, 3143). The underground geological formations encountered in the Van Horn area are alluvium and limestone or volcanic rock (Stanton 3143). Mr. Stanton has drilled commercial irrigation wells on Powell Farms, adjoining the northwest corner of SWS (Stanton 3247).

245. The evidence shows that the cost of a well is determined by the depth to the water, the diameter of the well, and the size pump (Stanton 3150–55). As with the cost of goods and services generally, the cost of well-drilling has increased in recent years.

246. According to Mr. Stanton, a domestic water well, for household use only, requires a well capable of producing 10 to 20 gallons of water per minute (Stanton 3149). A six and one quarter inch well (casing size) would be necessary to produce 10 to 20 gallons per minute. The cost to drill a six and one quarter inch well would be $13 a foot (probably more than that today) (Stanton 3150–51). Therefore, to drill to approximately 400 feet, the cost would be $5,000 for drilling costs, plus $1,500 for a pump (Stanton 3151). Respondents dispute this estimate, contending that for purely domestic use, a well capable of producing five gpm is sufficient (Holtz 3072; **[64]** Mitchell 3729). A home and moderate garden would require only 10 gpm, according to Mr. Mitchell (Mitchell 3729).

247. Grapes require three gpm per acre of irrigation (Campbell 3655). Thus, a house with a garden and a four and a half acre vineyard would need a well capable of producing about 25 gpm. Pecans require less than one gpm per acre (W. Bray 3784, 3786).[57] A windmill producing 10 gpm with a storage tank would be sufficient to irrigate 10 acres (RX 44; Gilmore 3957; 3968). Mr. Stanton testified that irrigation requires about eight gpm per acre (Stanton 3157). Mr. Holtz, a district conservationist with the Soil Conservation Service, testified that 10 gpm is sufficient to irrigate an acre (Holtz 3073). And sprinkle or drip irrigation would reduce the amount of water necessary (Holtz 3074). The irrigation wells on the Powell Farm (adjacent to SWS) produce 2,500 gpm and irrigate 500 acres, that is, five gpm per acre (Gunter 2883). In addition, there was testimony that an eight inch well, which is just slightly larger than the six inches normally used for purely domestic purposes, is sufficient to irrigate approximately 80 or 100 acres (Beasley 2853).

248. The county extension agent of the Texas Agricultural Extension Service informs potential small scale farmers that a well suitable for domestic and home gardening use will cost only $3,000 (Harlow

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[57] The Brays have 1200 pecan trees on 28 acres. Mr. Bray testified that they use 21 gpm to irrigate the entire orchard (Bray 3784–86).

2971).[58] Mr. Holtz, the district conservationist, testified that a well sufficient to provide for domestic use and 4 1/2 acres of irrigation in an area with a water depth of 400–500 feet would cost $5,000–$10,000 (Holtz 3072–73). An experienced irrigation engine salesman and former president of the Van Horn Chamber of Commerce testified that $6,000 to $8,000 would be enough for a well sufficient to irrigate as much as 15 acres (Mitchell 3736–37). Respondent Kritzler estimated that a well in the properties would cost from $4,000 to $7,500 (Kritzler 628).

249. Several customers testified that they had drilled wells, or had some other basis for ascertaining the cost of a well. Mr. Wharton was quoted a price for his prospective well in SWS of $7,000 to $8,000 (Wharton 3577). He testified that he believes he can have the well installed for as little as $4,000, **[65]** if he does some of the work himself or uses a smaller driller (Wharton 3577). Mr. Muller is in the process of building a house in GVA. He anticipates his well may have to be as deep as 600 feet, and cost less than $10,000 (Muller 3637).

250. A well driller was reported as quoting a price to Mr. Sanchez of $10,000 to $12,000 for a well in the hills of GVA (Sanchez 3700). However, he testified that he found some private drillers willing to drill the well for only $2,000 to $3,000 (Sanchez 3700–01). Thereafter, they drilled to 600 feet, and found water at 500 (Sanchez 3701–02). However, the well is crooked, and thus presently unusable. Consequently, he paid the drillers only $1,000 (Sanchez 3700–01, 3703). He anticipates it will cost another $1,000 to have the well straightened and to add the casing (Sanchez 3709). He plans to power it with a windmill, and therefore will not need a pump or electricity (Sanchez 3704). Thus, his total cost will be $2,000 plus the cost of a windmill.

251. The Brays installed a well on their property adjoining SWS in 1978 (W. Bray 3784). The well is 520 feet deep with water at the 90 foot level (W. Bray 3784–85). It produces 40 gpm, which is sufficient for domestic use, to irrigate 1,200 pecan trees and a large home garden, and to fill a one acre lake (W. Bray 3784–85).

252. Mr. Perkins, who is in the process of moving to GVA, was quoted a price of $7,000 to $8,000 for his well, but expects to have it done for less by doing some of the work himself (Perkins 4038, 4041).

253. George and Wilda Taylor were in the midst of constructing their house in GVA when they testified in November 1981 (G. Taylor 4595–96). They had contracted with a well driller named Brown in Marfa, Texas, to drill a well. Mr. Brown estimated that the well would be 450 feet deep and would yield 100 gpm (G. Taylor 4596). The cost will be $11 per foot, or an estimated total of $4,950, plus a pump (G. Taylor 4596).

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[58] In the last couple of years, inflation has raised the cost beyond $3,000 (Harlow 2971).

3. Financing

254. There is little evidence in the record regarding the availability of financing. There was testimony that the Van Horn branch of the Pecos Savings and Loan will not take land in SWS, GVA or GVA II as collateral (Stuard 3130).

255. However, there was also testimony that financing was available from other nearby sources, or by using other collateral (Smallwood 4054; Buck 1529). **[66]**

4. Equipment

256. The evidence offered by complaint counsel demonstrates that new farm equipment for a large farm, such as the equipment shown in RX 34, is beyond the financial capacity of an ordinary consumer (Gilmore 3987–88).

257. On the other hand, the record shows that equipment of the size and sophistication appropriate for an owner of 5 to 40 acres is available at reasonable prices (Wharton 3617).

5. Improvements

258. The only record evidence regarding "improvements," concerns the construction of a golf course in SWS, staking of the properties, and the construction and maintenance of roads.

a. *Golf Course*

259. The sales contracts used in the purchase of SWS property contain the following provision on the reverse side:

> Seller agrees to construct a nine-hole golf course before March 1, 1978. Upon completion of the golf course, Seller will form Sunsites Golf Club and will convey the golf course to Club, which shall thereafter be solely responsible for the operation and maintenance of the golf course. Buyer will become a charter member of the Golf Club at not charge. Buyer agrees to pay such fees as may be assessed by Club for course upkeep and maintenance, and Buyer further agrees that his rights and privileges in the golf course shall be subject to rules and regulations adopted by said Club (CX 74 75).

The identical provision is included in the fact sheets for SWS (CX 79 80, 81, 82). **[67]**

260. The face of the SWS contracts provide as follows:

> Upon becoming a charter member of the Sunsites Golf Club, referred to on the reverse side hereof, the Buyer will be responsible for whatever dues and/or assessments such Club might require, and nonpayment of such amounts may result in a lien of Buyer's property in favor of such club, if the rules and regulations to be promulgated by such club so state (CX 74, 75).

261. There were no representations concerning a golf course made for the GVA and GVA II properties. Hence, this aspect of the complaint relates only to SWS.

262. There was testimony that in mid to late 1978 respondents hired William Bray[59] and Bill Gilmore to construct the SWS golf course (Kritzler 484–85; Gilmore 1005). Mr. Bray thereafter designed the course, including the irrigation system, greens and tees, and the water hazards (W. Bray 3811). Mr. Gilmore handled the actual construction (W. Bray 3812). According to respondents, construction of the course cost approximately $80,000 (Kritzler 484; Shonfield 1258–59; *see* CX 10).

263. There was testimony that the course was completed around November 1978 (Gilmore 1007; Shonfield 1260; Compere 3224; Lowry 3117). An aerial photograph of the golf course is included among the photographs in Mr. Compere's appraisal report (CX 436 at the seventh page of photographs). The course is also somewhat visible in RX 49A. According to the testimony, at the time of completion the irrigation system was completed, the greens were in, and the fairways were beginning to grow (Kritzler 484). There is some dispute as to whether the newly seeded course was playable. Mr. Bray does not believe the fully constructed course was yet playable (W. Bray 3830), though an [68] employee of respondents, who was president of the property owners association ("POA"), testified that it did receive some minimal use (Shonfield 1260–61).

264. The SWS property owners association was incorporated in October 1978, and the golf course was deeded to it (CX 416; Shonfield 1260).

265. Shortly after construction work on the course was completed, it was destroyed by a massive rainfall (Kritzler 484–85; Shonfield 1266; W. Bray 3830; Gilmore 1008–09).

266. Thereafter, respondents undertook to reconstruct the course. Again, according to the testimony, the course was completed (Kritzler 485; Gilmore 1010). There was testimony that after the course was completed the second time, it was playable (Gilmore 1010). Mr. Wharton first visited SWS in March 1980 (Wharton 3566). This witness testified that the course was fully operational and well-maintained (Wharton 3608).

267. Subsequently, the Van Horn area was subjected to a severe drought, which destroyed the course a second time (Kritzler 486; W. Bray 3830). The course was not rebuilt.

268. The assessments collected by the POA had been inadequate to

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[59] Mr. Bray had some experience in golf course construction. As the assistant city manager of Tucson, Arizona, he testified that he supervised the engineering, design and construction of an 18 hole course, where the Tucson National Golf Tournament is now played. He testified that he also supervised the construction of a golf course in southeast Arizona (W. Bray 3767–69).

pay for maintenance and upkeep, and SWS paid for maintenance in addition to construction (Kritzler 485; Shonfield 1266–67; CX 416). In October 1980, the POA decided that given the low level of interest expressed in the course by the purchasers, and the failure of many purchasers to pay their dues, it would not be possible to continue maintenance of the golf course (CX 416).

269. The total expenditures by SWS for construction, reconstruction and maintenance of the golf course was in the range of $150,000 to $170,000 (Kritzler 485; Shonfield 1267). About half of this money was expended after SWS had fulfilled its contractual obligation to construct the course (Kritzler 485).

b. *Staking Of The Parcels*

270. For some, but not all, of the parcels of the properties sold by respondents a contractual obligation existed to stake the parcels. **[69]**

i. SWS

271. In SWS there was no contractual obligation to stake parcels (*see* CXs 74, 75). Nevertheless, there is evidence showing that lots in SWS were staked (*see* CXs 79B, 80B, 81D, 82D; Lara 3929). From June 1977 through December 1978, SWS, Inc. spent $71,683 on lot staking (*see* CX 10).

ii. GVA And GVA II

272. The contract for GVA provides "It is anticipated that the Seller will commence staking parcels by January 1977, and completion is estimated in 1978" (CX 76). The same provision is included in the GVA II contracts, though the commencement date is 1978 and the estimated completion date is 1979 (CXs 77, 78).

273. The firm of Cremans, Inc. was retained to stake the parcels (Lara 3929). Mr. Lara, of Cremans, testified that his firm had staked some of the parcels, but not all, and that he had no idea as to the percentage of parcels staked (Lara 3929). Concerning this, Mr. Gilmore, respondents on-site representative, testified (Gilmore 3975):

> Q. Are you familiar with whether the lots which are offered for sale are staked?
> A. All that we sell are staked, yes.
> Q. Is that one of the things you have oversight of?
> A. Yes, that's one thing I check is stakes.
> Judge Howder:
> If it's not staked you don't sell it?
> The Witness:
> Not unless the people want it, then we call the man—if we can't find the stakes we call the man to come out and restake it.

The witness Lara confirmed that his firm had in fact been summoned to stake individual parcels (Lara 3929). **[70]**

274. Mrs. Buck testified that she visited her property in GVA in February 1978. She contacted W.D. Smith in Van Horn, but he was unable upon their visit to GVA to show Mrs. Buck her specific plots. They could find no survey stakes designating the boundaries of the lots. Mr. Smith showed them land that was "off by two or three lots" (Buck 1511). Mrs. Buck testified that she visited GVA again in April 1978. The stakes to their parcels could not be found initially because they were buried about 18 inches deep under the ground (Buck 1515–16). In late November or early December 1978, there was testimony that Mrs. Buck and several other landowners at GVA contacted Mr. Kritzler regarding some of the conditions at GVA. They told Mr. Kritzler that many of the people living on GVA were unable to locate their specific boundary lines because the stakes could not be located (Buck 1533–34).

275. Another purchaser living on GVA on the land testified to similar problems with regard to staking. When Mrs. Smallwood purchased her lot it was not staked, and she was unable to build a fence to delineate her property lines. Mrs. Smallwood kept horses, and was allegedly harassed by Mr. Smith who insisted that the horses not run free. According to Mrs. Smallwood, she repeatedly asked Mr. Smith to stake the property so that a fence could be constructed. Mrs. Smallwood, who also participated in the property owners' meeting with Mr. Kritzler regarding the roads and lack of staking, succeeded in having her property staked some several months later (Smallwood 4069–70). In addition, Dr. Danskin testified that he did not see stakes on GVA II or SWS when he visited his properties in those two subdivisions (Danskin 2436, 2438; *see also,* Lambert 1786).

276. Notwithstanding the above, the record shows that from May 1978 through March 1979, $35,467 was spent by respondents on staking in GVA (CX 19). $16,993 was spent staking GVA II from May 1978 through October 1978 (CX 27).

c. *Road Building*

277. As with staking, respondents' road building obligations differed among the three properties.

i. SWS

278. In the eastern half of SWS, known as SWS Ranch (RX 49), respondents made no contractual promise to construct roads. The contract states "Seller will not construct any roads in Sunsites Ranch - Unit II. There is a 15 foot easement reserved for public use where necessary and along the boundaries **[71]** of all parcels for roads and

utilities" (CX 75B, no. 10). The fact sheet further explains the lack of obligation:

> ROADS AND STREETS.—Seller will not construct any roads in Sunsites Ranch - Unit II. There is a 15 foot easement reserved where necessary and along the boundaries of all parcels for roads and utilities. At its option, the Seller may form a property owners association to provide for the construction and maintenance of roads. If such association is formed, each landowner will be a member thereof and will be responsible for whatever assessments such association might require, and nonpayment of such amounts may result in a lien on Buyer's property in favor of such association, if the rules and regulations to be promulgated by such association so state.

279. In the remainder of SWS, the road building obligation is (CX 74B, no. 12):

> Seller has constructed and will continue to construct dirt access roads (15 feet and crowned). The buyer is responsible for the maintenance thereof. At its option, the Seller may form a property owners association to provide maintenance. If such association is formed, each land owner will be a member thereof and will be responsible for whatever assessments such association might require, and nonpayment of such amounts may result in a lien on buyer's property in favor of such association, if the rules and regulations to be promulgated by such association so state. Assessment will probably be on a per-parcel basis and is estimated to be $20.00 per parcel per year.

The fact sheets used for the portions of SWS where roads were to be constructed explain the road building obligation in a similar manner (CXs 79A, 80A, 81B). **[72]**

280. There is no record evidence which establishes that the roads in SWS were not constructed as promised.[60]

281. The evidence of record shows that respondents constructed roads in the western half of SWS and, although not obligated by contract to do so, maintained such roads (Kritzler 472, 477; W.D. Smith 905, 907–11; Gilmore 1019; W. Bray 3812; CX 10). The roads are visible in the aerial photograph of SWS (RX 49A). Moreover, complaint counsel's appraisal expert conceded the existence of well constructed and well maintained roads: "On the one on Southwest Sunsites it had a base to it, what I would call a caliche road and was a reasonably well-maintained road" (Compere 3223). The quality of the roads in SWS may be seen in the photographs of CX 153E.

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[60] One consumer witness, Dr. Robert Danskin, testified that when he visited SWS in 1978 he was unable to get to his property because a heavy rain had made the road impassable (Danskin 2435–36, 2452). Complaint counsel did not offer Dr. Danskin's contract in evidence. However, he testified that he purchased a 40 acre parcel (Danskin 2427). Other testimony in the record establishes that 40 acre parcels were sold only in SWS Ranch (Kritzler 4093–94). Thus, his parcel must have been in an area where there was no contractual obligation to construct any road (CX 75B).

ii. GVA And GVA II

282. As with SWS, there are two different road-building obligations in GVA and GVA II. In the southern portion of GVA II, the area in the mountains which was generally withheld from sale, there was no obligation to build roads. The contract states: "Roads and Streets—Seller will not construct roads to each parcel. There is a 20 foot easement reserved where necessary and along the boundaries of the parcels for roads and utilities" (CX 78B, no. 9).

283. In the remainder of GVA II, *i.e.*, the portion which adjoins Route 90, and in GVA, respondents were obligated to construct dirt ranch access roads, but were not obligated to maintain them. The contracts provided (CX 76B, no. 10):

> Roads and Streets—Seller will construct dirt ranch access roads to **[73]** each parcel. The Buyer is responsible for maintenance thereof. At its option, the Seller may form a property owners association to provide maintenance. If such association is formed, each land owner will be a member thereof and will be responsible for whatever assessments such association might require, and nonpayment of such amounts may result in a lien on Buyer's property in favor of such association, if the rules and regulations to be promulgated by such association so state. Assessment will probably be on a per-parcel basis. There is a 20 foot easement reserved where necessary and along the boundaries of the parcels for roads and utilities. It is anticipated that the construction of the roads will commence by January 1977, and completion is estimated in 1978.

The provision in the GVA II contract is identical, except that the anticipated commencement date is January 1978 and the estimated completion date is 1979 (CX 77B, no. 10).

284. A dirt ranch access road is an unpaved road without a crown and without drainage ditches.[61] This was explained in detail by one purchaser of land in GVA (W. Taylor 4619-21):

> Q. What is a "ranch road?"
>
> A. That's a dirt road, flat dirt road. It's never paved or graveled or anything.
>
> * * * * * * *
>
> Judge Howder:
>
> Are you saying that the roads in Green Valley are ranch roads in the sense of what you were used to before? **[74]**
>
> The Witness:
>
> Well, I always thought when you said "ranch road," it's an acceptable thing that that's not a paved road or graveled road. That's a road that's cut out of a pasture. You can drive across it, and its graded, and that's it.
>
> * * * * * * *
>
> Judge Howder:
>
> In your mind, is a ranch road supposed to have [drainage] ditches?
>
> The Witness:

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[61] One witness, Mrs. Buck, testified that she believed a dirt ranch access road to be a crowned road with drainage ditches (Buck 1501-02).

Oh, no, no, no.

Q. Are these roads [in GVA] graded?

A. Yes, they've been graded.

Q. And when you say "graded," what do you mean by that?

A. Well, they take a grader and go in there and push that dirt out and flatten that road out. And take that native grass that's cropped up . . . and take it out so that there's nothing there. Like the top of this desk (indicating). Except that the dirt that's taken out of the center is piled up on the side of the road. Just like you've seen a grader go down anyplace.

* * * * * * *

Judge Howder:

Does a ranch road, in your mind, imply a road which has a crown down the middle or just flat? What I mean, is the center higher than the sides? **[75]**

The Witness:

I don't know that much about it. I just know that they usually are flat—to me, the ranch roads that I'm familiar with are usually just flat roads. As a matter of fact, most of the ones that we went over [in] the places we had [*i.e.*, our previous ranches], had never been graded. We just went across the field.

285. The dirt ranch access roads were in fact constructed (Kritzler 471; W.D. Smith 905–11; Compere 3222, Lara 3917; Gilmore 3960). Numerous photographs in the record show the roads in GVA and GVA II (RX 50A, 36; CS 153I, 436, 88, 89). The roads in GVA cost $18,800 in 1978, and in GVA II they cost $13,000 from February 1978 to February 1979 (CX 19, 27).

286. Most of complaint counsel's evidence concerning roads in GVA and GVA II asserted not that they were not constructed, but that they have not been adequately maintained. However, the sales contracts explicitly state that it is the purchasers obligation for upkeep rather than respondents.

287. In any event, the evidence shows that most roads are maintained by the respondents at their own cost, and that the roads are in passable condition except for problems immediately following a rain (Compere 3224) ("reasonably well maintained"); (W.D. Smith 909; Gilmore 1019).

288. Those witnesses who complained that the roads are inadequately maintained admitted that the roads were constructed and that some maintenance was carried out at respondents' expense on a regular basis (W. Taylor 4617–18; Smallwood 4072, 4083; Buck 1534).

6. Practices Which Impair The Use Of Lots

289. Paragraph Thirteen (c) of the complaint alleges that the respondents engaged in unspecified practices which substantially impair the ability of purchasers to live on or use their lots. Complaint counsel identified only two such practices, *viz.*, failing to maintain improvements, and allowing cattle to graze on the properties. **[76]**

290. The golf course was maintained at respondents' expense al-

hough the contract explicitly allocated the cost of maintenance to the POA and the buyers (CXs 74B, 75). When the cost of maintenance ecame excessive, and lack of interest on the part of purchasers in sing the course became evident, SWS ceased maintenance (CX 416). The POA, having limited funds, and unable to collect assessments rom landowners, was unable to maintain the course (CX 416). No vitness testified that the lack of maintenance of the golf course affected his ability to use his lot.

291. The roads have also been maintained by the respondents, although the contracts explicitly allocate the responsibility for maintenance to the purchasers.

292. The claim that the leasing of the land for grazing impairs the ability of a customer to use his property is not reasonable. The contracts explicitly disclose that the land will be leased and that customers may fence cattle out of their property (CXs 75B, 76B, 77B, 78B).[62] In fact, fencing cattle out of non-grazing land rather than fencing them into grazing land is the procedure encouraged by Texas' open range law (Buck 1574; *Texas Revised Civil Statutes Art.*, Section 6954 et seq.). Moreover, respondents' right to lease the land for cattle grazing will expire in 1987 (CXs 75B, 76B, 77B, 78B). Moreover, there is no evidence that any customer's ability to use his lot was substantially impaired by the grazing of cattle.

C. *The Parcels Are Usable For Homesites, Farms And Ranches*

1. The Parcels Are Affordable As Homesites

293. The question is raised in this case whether the cost of a well, perhaps up to $10,000, or the cost of electricity, perhaps up to $5,000 (refundable), or the cost of other utilities and services, render it prohibitively expensive to use the property in issue as a homesite. In addition to these costs, the cost of a dwelling must also be considered. [77]

294. There is evidence in this record that costs of mobile homes are not prohibitive, and that such dwellings are often used in the Van Horn area (CX 532B). Mrs. Smallwood's mobile home (RX 46, 47) cost only $5,400 (Smallwood 4054). There was other testimony that mobile homes are available in the $10,000 to $15,000 range (Mitchell 3736). The Brays live in a mobile home (RX 40) which is 60 by 40 feet in size. It has two bedrooms, a bath, a kitchen, a dining area, a 32 foot front porch and a 20 foot screened in back porch (W. Bray 3796–97). This witness placed the total cost for the mobile home, including skirting, an evaporation cooler, and on-site delivery and anchoring, at $13,500

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[62] Respondents do not retain the right to lease land in western portion of SWS, and there is no evidence in the record that such land was leased.

(W. Bray 3796–97). The Bucks' double size deluxe mobile home cost $32,000 (Buck 1521, 1558).

295. Based on this information, it appears possible to commence living practically on respondents' properties for well under $50,000.

296. The fact that the land can be used as a homesite is evidenced by the fact that some people have and are currently using such tracts as homesites (W.D. Smith 968–70; Gilmore 995; Wharton 3566; Muller 3638; Perkins 4032; Smallwood 4053–54; G. Taylor 4595–96; W. Taylor 4614). These residents who chose to live on the properties do not appear affluent. Mr. Buck operated construction equipment for the Marines (Buck 1502). Mr. Muller is a self-employed car mechanic (Muller 3629). Mr. Perkins sells insurance (Perkins 4019). Mr. Wharton is a disabled truck driver (Wharton 3601). The Taylors are retired (G. Taylor 4601; W. Taylor 4617).

2. The Tracts Are Usable As A Farm Or Garden

a. *Soil, Water and Climate Conditions Permit The Growing Of Crops*

297. SWS is in Wild Horse Valley, immediately north of Michigan Flats, while GVA and GVA II are in Lobo Valley (Reed 2608). These are presently the only farming areas in Culberson County (Holtz 3085; Harlow 2967). All three properties are surrounded by farms (RX 49, 50, 436 (photographs of surrounding farms), 170 (photographs of neighboring farms); Gilmore 1021–22; 3944–55, 3962–63, 3966; Conoly 1060; Gunter 2907–08; Harlow 2984; Campbell 3640; Mitchell 3763–64; W. Bray 3783–84, 3801; H. Bray 4002; Lara 3915, 3923; [**78**] Smallwood 4045; Kritzler 4091, 4139; Wolfe 4555; Wharton 3578; Campbell 3640; RXs 27, 28, 29, 30, 31, 32, 33, 34, 38, 43)).[63]

298. These neighboring farms raise a wide variety of crops. Powell Farms adjacent to SWS grows cotton, maize and barley commercially, and vegetables for home consumption (Gunter 2878, 2917). The Brays raise pecans on land adjoining SWS (W. Bray 3784). A large pecan orchard is located less than two miles from SWS (Gilmore 3947). A farm across Route 10 from SWS raises hay and grapes (Gilmore 3952–54). The University of Texas has an experimental vineyard raising grapes just south of SWS (Campbell 3640). Cotton, corn, milo, lettuce and onions have been cultivated in the areas of the properties (Mitchell 3726; Gilmore 3944–52). Potatoes are grown approximately a mile from SWS (Gilmore 3948). Rye or wheat is grown immediately north of GVA (Gilmore 3983).

299. Farms in the Van Horn area raise cotton, wheat, barley, grain

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[63] The ten photographs numbered RXs 27–34, 38, 43 were identified and explained by witness Gilmore at 3944–55, 3962–63, 3966.

sorghum, alfalfa, potatoes, pecans, and onions (Holtz 3042, Harlow 2927). The county agriculture extension agent informs prospective farmers or gardeners that the crops grown in the area include pecans, grapes, apples, pears, plums, peaches, carrots, lettuce, turnips, cantalopes, tomatoes, cabbages and onions (Harlow 3987; CX 532). Newspaper articles refer to area farms growing onions, pecans, and grapes (CXs 90, 92, 99, 133, 266).

300. Mr. Kritzler testified that when respondents first purchased the three properties, they were aware of the extensive agriculture in the area (Kritzler 4091). He testified that the respondents visited the properties and the surrounding areas, looked at the farms, sought information from the county extension agent and the local chamber of commerce, and formed the belief that the soil was fertile, the water excellent in quality and abundant in quantity, and that the properties could be used productively (Kritzler 4091). The district conservationist with the Soil Conservation Service was also consulted. He testified that he told the respondents that the soil, water and climate were conducive for farming (Holtz 3078).

301. Dewey Compton, an agronomist respected by respondents (Kritzler 4096), took samples of the soil in SWS and submitted them to the Soil Testing Laboratory of Texas A&M University and the Agricultural Extension Service. The subsequent report **[79]** suggests, *inter alia,* that "a very small amount" of fertilizer would be necessary, along with some zinc if fruit trees were to be grown (CX 237).

302. Information was also sought from a Dr. Sam Little concerning soil fertility in Lobo Valley. Dr. Little reported favorably as to the climate, soil and water (CX 220A-D). As to the climate, he reported that it "would no doubt come as close to 'ideal' as you could probably ever hope to get" (CX 220A).

303. Dr. Little analyzed the soil in the level areas of GVA, the moderately sloping areas with a sandy to gravelly surface, and the gentle slopes with a sandy surface. As to the first of these, he found that the soils "are deep, are dark brown in color with about 36 inches of topsoil underlaid with brownish colored subsoil about 60 inches deep." The soils are "relatively high in humus and are high in calcium, magnesium, potassium, phospherous and nitrogen." He concluded that the soils "are especially well suited to producing excellent yields" of grain sorghums, cotton, soybeans, corn, wheat, barley, alfalfa, sunflowers, sugar beets, oats, onions, cantalopes, beans, tomatoes, peppers, sweet corn, squash, cabbage, lettuce, watermelon, peaches, pears, grapes, plums, apricots, pecans and figs (CX 220C).

304. As to the moderately sloping areas with a sandy to gravelly surface, Dr. Little concluded that the soils are three feet in depth, take water well, are well drained, and have very little runoff. He found

these soils suitable for any of the crops previously listed, but especially well suited for fruit and nut crops because the moderate slopes provides good air drainage (CX 220D).

305. The third type of soil is found on gentle slopes with a sandy surface. Dr. Little concluded that these soils "have an ample supply of all the needed plant foods," and are three to five feet in depth. These soils he reported to be high in humus, calcium, magnesium, potassium, phosphorous, and nitrogen. His final conclusion was that these soils are "especially well suited to producing excellent yields" of the same crops as he listed for the level areas (CX 220E).

306. Several witnesses, expert and lay, stated opinions concerning the productivity of the properties. The County Extension Agent, Mr. Harlow, testified that the soils will produce "whatever you want" with the addition of certain elements (Harlow 2925). He attested to a long growing season (Harlow 2925). He also stated that Culberson County is "roughly free of insects," and the home gardens "have very few problems with insects" (Harlow 2954). This was also voiced by one gardening resident of SWS (Wharton 3608). **[80]**

307. There was also testimony by the District Conservationist with the Soil Conservation Service, Mr. Steve Holtz (Holtz 3027). This witness gave the following general opinion concerning the suitability of the area for raising crops (Holtz 3042):

> As far as farming, most of the area, including the wildhorse farming area northeast of Van Horn and the Lobo area to the south of Van Horn, the soils are very conducive to irrigated farm land. . . . [It] is good crop land. . . .

308. Some purchasers sought specific assistance from Texas A&M concerning farming. They reported that they were told that the properties were conducive to the raising of crops (G. Taylor 4606; W. Taylor 4612–13). Mr. Ted Rose, a sales representative of respondents, testified that he ascertained from Texas A&M and two Texas agronomists, Dewey Compton and Murray Cox, that the land and climate were suitable for farming (Rose 709–10).

309. There was also testimony by witnesses engaged in growing vegetables in or near the properties. Two witnesses testified about crops grown in home gardens not on the properties but in the local Van Horn area. Mr. Milburn Mitchell's home garden in Van Horn includes onions, beets, carrots, okra, lettuce, corn, tomatoes, potatoes and pecans (Mitchell 3728). The Brays' garden, on property adjacent to SWS, has squash, green peppers, chili peppers, tomatoes, corn, chard, strawberries, grapes, pecans, and 38 fruit trees (H. Bray 4002). Samples of the Bray's produce were handed around at the hearing (H. Bray 4002–03).

310. The record further shows that crops are grown on the three properties, both commercially and in home gardens. There is a commercial pecan orchard in GVA (W.D. Smith 906, 949; Gilmore 1003, 3966–67; RX 43). Another 170 acres in GVA is, or recently was under cultivation, 100 acres in alfalfa and 70 acres in oats (W.D. Smith 975; Gilmore 1002, 3962–63; RXs 37, 43).

311. A number of the residents described their home gardens and the results they have had. Mr. Wharton testified that his garden was about 40 feet by 15 feet, and he described it as follows (Wharton 3582–84):

> A. We put out corn, sweet corn, we put out pinto beans. . . . We had carrots, **[81]** onions, we had black-eyed peas. . . . And watermelons.
>
> * * * * * * *
>
> Q. What kind of results did you have from your garden?
>
> A. Unbelievable.
>
> Q. What do you mean by that?
>
> A. The ground will grow anything. No fertilize[r].
>
> Q. Just water?
>
> A. Just water.
>
> Q. Can you give us an estimate or an indication of how much you were able to grow in the garden?
>
> A. I've never seen beans set on as many times as the ones set on out there. The normal in even irrigated ground on pinto or northern, which I've raised both of them commercially before, you consider four settings a good crop, that's four sets of blooms, which the bloom ends up being a bean. And we had six, seven settings when I pulled them up and throwed them over the fence because we were burned out on them.
>
> * * * * * * *
>
> Q. How about the watermelons?
>
> A. Watermelons, we started eating them, the first ones we eat weighed 24 pounds a piece. We only put out two vines of watermelons. In other words, two plants. And we have eat 12 watermelons off of it. I have fed 6 or 8 to the hogs, and there is still 16 in the garden, oh, about like that (indicating). Right now they're probably about 10 pounds. **[82]**
>
> Q. How big did some of these get?
>
> A. The biggest one I give to a neighbor weighed 40 pounds. The next to the biggest one I took it up to Bill Gilmore's and the wife and I and him eat it, it weighed 35, that was the two big ones. All the rest of them, the heaviest was 25 pounds. . . . I've never seen a watermelon vine produce over four good melons before. And then the heck of it is, they're still there and they're still blooming right today [October 20].

312. And again (Wharton 5600):

> Q. You mentioned in your last answer pecans, do you have pecan trees?
>
> A. I have eight pecan trees out, and I have three grape [vines], and I'm putting in two more lines of pecans which will be nine in each line, and then they'll be five grapes, raspberries, and blackberries on the other end of the [irrigation] drippers.

313. Mr. Gilmore gave similar testimony about this garden in SWS (Gilmore 1027–28; *see also* 3978):

> Q. Now Mr. Gilmore, in your—in your direct testimony, you talked about the crops, produce, that was available on your property. Be specific. What kinds of crops are you able to grow on your property? And have you grown on your property?
>
> A. Well, carrots, rutabagas, turnips, beans, peas, cabbage, Brussel sprouts, broccoli, zuccini [sic] squash, summer squash, banana squash, acorn squash, all kinds of chilis, radishes,—**[83]**
>
> Q. Domestic?
>
> A. Tomatoes.
>
> Q. How about potatoes?
>
> A. Potatoes.
>
> Q. Corn?
>
> A. Corn. Beets, cucumbers.
>
> Q. Do you eat this food?
>
> A. Watermelons.
>
> Q. Do you eat this food?
>
> A. Oh, yes.
>
> Q. Just describe how plentiful you can produce these crops. Not what you can do, what you have done?
>
> A. I raised so much last year I had to take it to town and sell it or give it away.
>
> Q. What size parcel where you raised so much?
>
> A. Well, I had a quarter acre [under cultivation].

314. Mr. Wharton explained in very practical and understandable terms how productive his garden is (Wharton 3585–86):

> Q. How much of your own diet comes from your garden?
>
> A. Up until, oh, I'd say [until the] first of October, a good 50 percent of its was coming from the garden, maybe heavier.
>
> Q. How much money did you have to supplement your living expenses with last summer? **[84]**
>
> A. We had two months, August and September, one month we got by on $46 and one month we got by on $47.
>
> Q. For your total living expenses?
>
> A. Total living, that included butane and the electricity bill.
>
> Q. Everything else you took from the garden?
>
> A. Yes, sir.

315. Although Wharton has experience as a commercial farmer, he stressed that cultivation of a home garden of 10 acres does not require any particular experience, although perhaps some helpful advice (Wharton 3611–12).

b. *The Cultivation Of 5 To 40 Acre Parcels*

316. The only issue remaining on the subject of gardening is the feasibility of growing crops on parcels of the sizes sold by the respondents, 5 to 40 acres.

317. Mr. Holtz has resided in Van Horn for the last six and one-half years. He is the District Conservationist with the U.S. Department of Agriculture Soil Conservation Service. Prior to this position he was a ranch conservationist with the U.S. Department of Agriculture in Abilene for three years, and for one year was a ranch conservationist in Rotan, Texas. He received his B.S. from Texas A&M in Range Science, and his Masters in Range Science from Texas A&M also, the latter in 1970. He was recognized as an expert on farming and ranching conditions in Culberson and Jeff Davis Counties (Holtz 3027–41).

318. His duties and responsibilities with the Department of Agriculture in Van Horn include managing other soil conservation officers, working closely with farmers and ranchers in their operations, solving their conservation problems, giving them technical assistance in implementing such practices, and running an educational program to inform farmers and ranchers of the programs and practices that are available to assist them. Mr. Holtz's area of responsibility includes 95 percent of Culberson County, and the western half of Jeff Davis County. His total area of responsibility includes a little over four **[85]** million acres. The subject properties are within the area of Mr. Holtz's responsibility (Holtz 3028–30).

319. C.E. Harlow has been the Culberson County Extension Agent since 1960. He has a B.S. degree from Texas Tech University and a Master of Education from Sul Ross College. His duties are to dispense educational materials developed by land grant colleges to area farmers and ranchers (Harlow 2920–22).

320. Finley Gunter has been a farmer in the Van Horn area for over thirty years. He ran the Cottrell Farm, totaling 5200 acres, for thirty years. The Cottrell Farm is north of Powell Farm. Mr. Gunter also managed the Powell Farm for two years. Powell Farm has 11,000 acres in cultivation, including 5,000 acres in cotton and 3,000 acres in milo (Gunter 2876–78).

321. These witnesses testified concerning many aspects of farming and ranching. In the Van Horn area, costs necessary to prepare the raw land for farming include clearing the land ($100–$125/acre); land smoothing for irrigation purposes ($175/acre), which involves "breaking" and "disking" up to 14 inches with land leveling equipment up to nine separate times; well drilling ($65,000 and up for a well sufficient for 150 acres); installation of an irrigation delivery system; tractor and equipment (a cotton stripper costs between $40–$65,000 and a large tractor $50–$80,000); selecting a crop, seeding and watering it correctly, fertilizing and herbiciding it, weeding, and harvesting it (Holtz 7044–53; Gunter 2895–96). Machinery necessary to commercially farm in Culberson County include large tractors, planters, cul-

tivators, large disks (land clearing), and bedding equipment (Harlow 2936).

322. Crops grown in Culberson and Jeff Davis Counties include cotton, wheat, barley, grain sorghum, alfalfa, and some potatoes, pecans, and onions (Holtz 3042; Harlow 2927).

323. Based on Mr. Gunter's experience, the best type of crop to grow in the Van Horn area is cotton. The only vegetable Mr. Gunter has seen grown commercially in the Van Horn area is onions. However, they were not successfully grown. The cost per acre for onions using already cleared land is $2,000/acre. This figure does include equipment costs and costs for the land (Holtz 3044–53). Mr. Gunter did not try to grow other vegetables on the farms he managed becaused he did not have any reason to believe it could be successfully done (Gunter 2890–92, 2908). Tomatoes are not currently being grown commercially in Culberson County (Holtz 2932).

324. Cotton is said to be the cheapest crop to grow in the Van Horn area. In Mr. Gulter's experience, it costs approximately $350/acre to grow. Costs associated with growing **[86]** cotton include the costs of production, breaking and clearing the land, fertilizers, water, seed, and pesticides ($50/acre). All crops grown in the Van Horn area must be treated with pesticides. Crop predators include boilworms, flea hoppers, and aphids (Harlow 2954). In addition, there are well drilling and irrigation system costs and harvest costs (Gunter 2886, 2892–93). The cost of tomato production is approximately $820/acre. This includes seed, fertilizer, insecticide, herbicide, machinery, irrigation, labor, utilities and supplies, and interest on loans. Harvesting costs (labor and machinery), and hauling transportation costs are separate (Harlow 2929–30).

325. The Van Horn area has a 224 day growing season with an average rainfall of 10 inches. The climate is such that there is no dry land farming capability and all farming must be done through irrigation. Native vegetation includes grassland, most of which has been depleted and replaced by brush (Holtz 3034–36, 3042).

326. In Mr. Holtz's district, 98 percent of the land is currently used for farming and ranching. Of that, less than 1 percent is in farming (Holtz 3033–34).

327. There are only 16–17 farmers who operate commercial farms in all of Culberson and Jeff Davis Counties. The average farm size varies from 320 to 17,000 acres. In the last ten years, the number of farms has decreased, and the average farm size, which was 400–500 acres, has now increased to approximately 1,400 acres. At the present time, there are approximately 15,000 acres that are not being farmed that were farmed a few years ago. The reason for this is that production costs have "skyrocketed while product prices have not increased

substantially." Pumping costs for irrigated water have gone up dramatically as have labor costs (Holtz 3044; *see* Harlow 2928; Mitchell 3762). The minimum acreage needed to farm commercially in the Van Horn area is between 160–400 acres "but it would be a bare minimum (at) making a living and you would have to do everything just right" (Holtz 3054; *see* Gunter 2905–07). Mr. Wolfe, former owner of the SWS property, testified that it would be "totally irresponsible to think . . . Sunsites would be developed for people who wanted to move out there and make a living. Or produce a living." Mr. Wolfe further testified that "no one in their right mind could tell you, or you believe that that would be a commercial enterprise" (Wolfe 4581–83).

328. All of complaint counsel's agricultural witnesses testified that there is a substantial risk involved in farming. Mr. Harlow described the risk of commercial farming as follows: "to be a farmer you nearly have to be crazy sometimes because there is a great risk involved in making a profit but they have got to know their land" (Harlow 2935). Mr. Harlow stated there **[87]** was a high risk for vegetables, high interest rates made loans very expensive, and weather conditions added to the risk (Harlow 2935). Mr. Gunter described the risks associated with farming in the Van Horn area as "terrible." They include weather, timing on when to gather crops, and the problem with insects (Gunter 2896–97).

329. In Mr. Holtz's opinion, the risks of commercial farming in the Van Horn area are the very high water pumping costs, which have increased from 50¢ to $2.25 a thousand cubic feet in the last six or seven years. Given the substantial outlay for farming costs production, a hailstorm, a cold spring or a flood is a hazard. Also, the extremely hot and dry summers aggravate any deficiency in irrigation (Holtz 3053–54).

330. Although general farming skills were deemed very important, Mr. Gunter found that people coming into the area were seldom successful in farming unless they had an understanding of the water situation and knew the importance of timing different operations. Farming in the area is determined by the depth of the water. Since the water is "pretty deep," it requires a little difference in operation compared to other areas (Gunter 2890, 2900–01). Extensive farming experience and a knowledge of the area are very important (Harlow 2955). It can take one from seven to ten years to get a return on investment (Harlow 3339).

331. Markets for crops produced in or about Van Horn are located in El Paso, Lubbock, or San Angelo, all a goodly distance away. There are few, if any, local markets (Holtz 3053) and none for vegetables or cotton (Harlow 2951). There is no local market for livestock in Culber-

son County. The closest livestock market is San Angelo, Texas, 350 miles distant (Harlow 2961).

332. On the subject of small garden type agriculture, as a result of numerous letters requesting information about the subject properties, Mr. Harlow and a Mr. Peavy, Extension Horticulture Specialist, Texas Agricultural Extension Service, Texas A&M, residing in Fort Stockton, Texas, composed a form letter (CX 532). The "Introduction" to this states as follows:

> Many people dream of leaving the crowded city to move to the country to make a living off the land on a 2 to 5 acre mini-farm growing and selling fruits and vegetables as a commercial venture. This is usually a difficult venture at best, and is usually not advisable UNLESS the mini-farm is located close to a population [88] center (usually within 10 minutes driving time of the city limits of a town of 25,000 or more).

333. In the "Living Off the Land" section, CX 532 advises people that in the Van Horn area, it is necessary to have the financial resources to pay for utilities, clothing, transportation, and "It is therefore chiefly for retired people with a cash income." CX 532A describes the type of expenditures needed for water for irrigation:

> Water for irrigation—You can put in a domestic well for a dwelling and a large one-tenth acre home food garden for $3,000 but for the large amounts of water needed for 2–5 acres of crops you have to drill a deep water well 500–600 feet deep at a cost of $10,000–$20,000.

334. This exhibit also describes problems associated with growing conditions as follows:

> Experience or know-how—Successful fruit, nut, or vegetable production in Southwest Texas requires a great deal of know-how. Growing conditions are difficult. The soil tends to be saline (salty) and low in organic matter.
>
> Getting a stand of plants is often difficult. Nitrogen is always deficient but nitrogen fertilizer is expensive, difficult to find, and must be hauled in long distances.
>
> A year's subsistence while you "get your feet on the ground" and get acquainted with your mini-farm. You are not likely to break even so have enough money saved for at least a year of crop failure.
>
> Equipment and buildings required:

Small, 4-wheel tractor	$1500
Implements for tractor	1000
Shed, barns	2000
Total Estimated	$4500 [89]

> Operating Expenses (seed, fertilizer, insecticides, etc.)—

This varies widely depending on the kind of crop and number of acres, but generally $200–$500 per acre must be invested in a crop to get it to harvest. You have to either furnish this operating capital yourself or borrow it.

335. The extent to which a person may become self-sufficient on his parcel was demonstrated by the testimony of purchaser-witness, Wharton, who owned 10 acres in SWS. According to the witness, he cleared five acres by hand, and five by burning the brush. Thus, he had no expenditures in clearing his land (Wharton 3579).[64] He fenced five of the acres, and in March 1981, planted a garden about 40 feet by 15 feet (Wharton 3581–82). From this small garden in the first summer of cultivation, Wharton testified that he derived much of what he needed to sustain himself, expending only about $45 per month for electricity, gas, milk, and meat (Wharton 3585–89). Wharton also raised chickens and a few hogs, fed from scraps (Wharton 3585). He has plans to raise and sell 24 hogs each year, which he intends to feed by planting four of his ten acres in corn (Wharton 3589–90).[65]

336. On his remaining acreage, Mr. Wharton testified that he will raise two calves, one of which he will butcher each year. He believes that the native grass on about five acres, after the brush is removed, will be adequate to feed two calves (Wharton 3595–99). He has also planted eight pecan trees, and will add another 18, along with some grape vines and berry bushes (Wharton 3600).

337. Mr. Gilmore, who has a full-time job as the on-site manager for respondents, has also raised a substantial amount of food for his needs in a home garden (Gilmore 1027–28). Although [90] his quarter acre garden obviously does not make Gilmore self-sufficient, he testified that it permits him to live on a salary of only $900 per month (Gilmore 984).

338. Mr. W.D. Smith, a previous on-site representative, also testified that a person could subsist by raising a labor intensive crop (W.D. Smith 934). He gave an example of how that could be done: three acres of alfalfa, three of pinto beans and three of onions, chili peppers, melons or squash would produce a sufficient return to support a family, in his opinion (W.D. Smith 935).

339. Mr. Holtz was also of the belief that it was possible for a person to support himself on a small acreage farm with a labor intensive crop, such as onions, tomatoes, chili peppers, or cabbage (Holtz 3091, 3093).

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[64] Mr. Gilmore estimated that it would cost $400 to clear five acres if the owner did not do the work himself (Gilmore 3986).

[65] Mr. Wharton believes it will require 300 bushels of corn to feed two sows and 24 hogs, 75 bushels per acre. In his previous farming experience, he testified that he never failed to raise at least 80 bushels of corn per acre (Wharton 3589–90).

340. Mr. Harlow also testified that with a home garden smaller than one acre a person could live off his crops as well as supplement his income (Harlow 2985–86).

341. Complaint counsel's expert appraiser witness also testified that numerous studies prove that land in five to 40 acre parcels can be an economic unit; that is, land of that size can provide sufficient economic return to support a family (Compere 3189). Compere's statement in this regard is as follows (Compere 3471):

> Several economic studies have been done by Texas A&M[;] University of Texas, El Paso; Sul Ross State University; and the West Texas Council of Governments, among others as to what type of improvements can be added to a small five to forty acre tract of rural West Texas land to make that tract a viable economic unit.
>
> These studies have shown many uses. Some proven and some only hypothetical that could at least theoretically return an economic profit to the developer.
>
> Those units studied include but are not limited to fish farm, shrimp farm, pecan orchard, grape vineyard, ornamental cactus farming and greenhouse tomatoes, which in the studies all of these ventures showed an economic profit. [91]

342. A witness employed at the University of Texas experimental vineyard testified about the feasibility of commercial grape growing on a small acreage tract (Campbell 3640; RX 26). The University has concluded that the Van Horn area, specifically Michigan Flats immediately south of SWS, can feasibly produce high quality grapes (Campbell 3647–48).

343. Campbell gave detailed testimony concerning costs involved in raising grapes, and the potential profits to be earned. The cost of planting the vines and caring for them for the first three years is $6,000 per acre (Campbell 3653–54). This figure includes the cost of the plants, the irrigation system, labor, and all other initial costs except the well and a tractor (Campbell 3654–56). Since a vineyard needs only three gallons per minute per acre for irrigation, a domestic well can easily supply the needs of a five acre vineyard (Campbell 3655). A tractor must also be purchased, at a cost ranging from $200 for a used tractor (Wharton 3617) to $1,500 for a small new tractor (CX 532), to $8,000 for a large new tractor (Campbell 3667).

344. From year four through six, there is an annual cost of $1,000 to $1,500 per acre (Campbell 3656–57). During these three years, the income from the grapes would offset the annual cost (Campbell 3670).

345. After the sixth year, the income from the sale of grapes will exceed the annual expenses by $1,000 to $1,500 per acre (Campbell 3659). The annual profit on a five acre vineyard the witness placed at from $5,000 to $7,500. Assuming an initial investment of $30,000 to $40,000 and an annual profit of $5,000 to $7,500, a five acre vineyard yields a return on capital of 12.5% to 25%. On a ten acre vineyard,

with an initial capital outlay of $70,000 ($6,000 per acre and $10,000 for a tractor and equipment), and annual profits of $10,000 to $15,000, the return on capital increases to 14% to 21%.

347.* There was testimony concerning the raising of pecans on parcels of the sizes sold by the respondents. Mr. Bray planted 28 acres of pecan trees in 1978 on land adjoining SWS (W. Bray 3784). On the 28 acres, Mr. Bray planted 1,200 pecan trees, about 42 per acre (W. Bray 3785). To supply water for the orchard, as well as for his garden, home and pond, Mr. Bray had a 12 inch well drilled to a depth of 520 feet. The cost of the well and pump was stated to be $7,500 (W. Bray 3784–85). A drip type irrigation system was installed, which permits irrigation of the full 28 acres from a well which discharges 40 gallons per minute (W. Bray 3785). Mr. Bray calculated the total cost for the trees, labor for planting, and the irrigation system to be $13.50 per tree (W. Bray 3789). At 42 trees per **[92]** acre, the initial cost came to $567 per acre, or $15,876 for the full 28 acres. If the full cost of the well is allocated to the orchard rather than the home or garden, the full cost would be about $23,376, which comes to $831 per acre.

348. A pecan tree first produces nuts in the third year after planting (W. Bray 3791). The first profitable year would be the sixth year, at which time each tree will produce about 10 pounds of pecans. (W. Bray 3791). The yield per tree increases by about 10 pounds per year until a maximum of 150–160 pounds is reached (W. Bray 3815). That level is maintained for 60–70 years, after which it will decline slightly for the remainder of the tree's 150 year life (W. Bray 3815–16).

349. Mr. Bray testified that his annual costs for his 1,200 trees was $175 for fertilizer, $10 for zinc spray, and about $300 for electricity to run the irrigation pump, for a total of $485. The cost of harvesting is negligible in the early years (W. Bray 3861). At the present time, pecans wholesale for about $1.10/pound (W. Bray 3863). Mr. Holtz testified that there is no market shortage for pecans (Holtz 3077).

350. As a general rule for pecan growing, according to Mr. Bray, expenses are about 35% of the gross, and profits are 65% (W. Bray 3863). Thus, in the sixth year after planting he placed the gross income per acre at $462 (42 trees x 10 pounds per tree x $1.10 per pound), and the gross profit at $300 per acre. In the seventh year, he estimated the profit to be about $600/acre. A five acre parcel, with trees on 4.5 acres, would thus return a sixth year gross profit of about $1,350, on an initial investment of $2,551.50 (42 trees per acre x 4.5 acres x $13.50 per tree). Accordingly, the profit in the seventh year would be about $2,700, equal to the entire initial cost.

351. Mr. Hugh Wolfe also testified the economics of pecan growing. Mr. Wolfe was previously the owner of Wolfe Nurseries, the largest

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* There is no Finding 346

wholesale nursery in the southwest (Wolfe 4540). Wolfe Nurseries' main production was in pecan trees (Wolfe 4540).

352. Mr. Wolfe stated that the Van Horn area had "the potential of being a tremendous pecan producing country" (Wolfe 4556), and that the soil and water in SWS have "excellent" suitability for pecan growing (Wolfe 4574, *see* 4577). Dr. Sam Little was also of the belief that the GVA area would support the growth of pecans (CX 220C, D, E).

353. Mr. Wolfe testified that he recently visited the Brookshire Orchard, a 200 acre pecan orchard four or five miles from SWS (Wolfe 4555). He reported that this orchard is in its sixth year, and this year produced 10 pounds of nuts per tree (Wolfe 4555). He confirmed that pecan production normally increases for about 20 years before levelling off (Wolfe 4556). **[93]**

354. Mr. Wolfe estimated that the costs of purchasing pecan trees, building an irrigation system, drilling a well, planting the trees, and caring for the trees for the six years prior to a commercial crop to be $1,000 per acre (Wolfe 4562). He estimated the present wholesale price for pecans to be $1.50 per pound (Wolfe 4561, 4579).

355. In sum, Mr. Wolfe was of the opinion that pecan growing on four and a half acres was an excellent long-term investment, and would be commercially feasible, especially for retired folk (Wolfe 4575).

356. There is a pond on respondents' property in SWS which is stocked with catfish (W.D. Smith 971; Mitchell 3754; W. Bray 3796). There are also catfish in Mr. Bray's pond (W. Bray 3795). Mr. Bray testified to the feasibility of fish farming. He had subscribed to the magazine of the National Catfish Association, and researched the market in El Paso for catfish (W. Bray 3794–95). According to him, it is feasible to farm catfish in SWS (W. Bray 3795). He stated that the ideal lake size for catfish farming is one half acre (W. Bray 3795).

357. Reference was made in this proceeding to the guayule plant, and to two other plants jojoba and euphorbia. Guayule is a native desert shrub from which one can produce natural rubber (Bragg 2681–82). In 1978, Congress and the rubber industry were interested in the possible development of a guayule industry in America (Bragg 2711); *Guayule Rubber Development: Hearings on S. 1816 Before the Subcommittee on Regional and Community Development of the Committee on Environment and Public Works,* 95th Cong., 2d Sess. (1978).

358. Guayule was referred to in some of respondents' promotional materials (*see* CXs 119, 120, 300), and was reportedly mentioned to one prospective purchaser (Mr. Lueckel). CX 119 is a copy of a newspaper article dated May 5, 1978, which indicates that the Senate is likely to consider a bill authorizing a $30 million study of the feasibility of

cultivating guayule in the southwest. CX 120 is a copy of the title page of the Guayule Rubber Development Bill introduced in Congress in 1978. The exhibit also contains a very brief description of guayule. CX 300 is a reprint of an article from Texas Business magazine published in August 1978. It is entitled "Energy grows on Texas trees," and discusses the "fledgling" petroculture industry, involving, *inter alia*, guayule.

359. Mr. Lueckel testified that in late 1977 he was told by a representative of Porter Realty that he might earn a profit on **[94]** land in GVA because Congress was about to appropriate $30 million for development of the guayule industry. On cross-examination, he testified that he realized there was no assurance the bill would be enacted, and there was no assurance that if enacted the bill would benefit his property (Lueckel 1847, 1865–66).

360. An expert, Mr. Daniel Bragg, testified that in 1978 there was interest in developing a guayule industry, especially in the military, and that such interest resulted in the enactment of the Native Latex Commercialization Act of 1978,[66] which authorized the expenditure of $30 million to develop a guayule industry in the southwest (Bragg 2711, *see* 2701). The Act authorized the Secretary of Agriculture to contract for the planting of 500,000 acres of guayule, to establish nurseries for seedlings, to construct and operate factories for extraction of rubber from guayule, and to purchase and maintain equipment for harvesting and processing guayule (7 U.S.C. 171). However, the $30 million was never appropriated by Congress (Bragg 2702).

361. Mr. Bragg identified himself as a graduate engineer with a bachelor and master's degree in industrial engineering. His current position is that of Assistant Director of the Center for Strategic Technology, a division of the Texas Engineering Experiment Station which is part of the Texas A&M system. He has worked for Texas A&M since 1970. Among other things, the Center for Strategic Technology studies alternative energy economics and innovative crops. Mr. Bragg is also a member of a number of professional societies. He founded the Guayule Rubber Society in 1979 and is the secretary of the Texas Jojoba Growers Association. Mr. Bragg's area of specialty is the preparation of economic feasibility analyses. He has done economic analyses of jojoba and guayule and has testified before Congress with regard to these plants (Bragg 2670–78). Mr. Bragg was qualified as an expert on the growth, production, development, processing, and costs associated with guayule, jojoba, and euphorbia (Bragg 2681).

362. Guayule is shrub plant indigenous to the Chihuahua Desert in Mexico and southwest Texas (but not the immediate area of the subject properties). It is a typical desert plant that has the unique charac-

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[66] Pub. L. 95–592; 92 Stat. 2529 (Nov. 4, 1978).

teristic of being able to produce natural rubber. During World War II and again during the Korean War, efforts were made to develop production of guayule rubber. However, these efforts were abandoned after these conflicts ended (Bragg 2681–82; *see* CX 531). **[95]**

363. Jojoba is a plant indigenous to the Sonora Desert, an area in the southern extremities of Arizona, California, and parts of Mexico. Jojoba is one of two sources of a peculiar liquid that is a valuable lubricant for industrial uses. It is also used as cosmetic base (Bragg 2686–87).

364. Euphorbia is a plant that grows wild in northern California. Euphorbia is a latex producing plant that happens to have a molecular structure almost identical to that of crude oil (Bragg 2688):

365. At present these plants have little, if any, commercial usefulness. As Mr. Bragg explained (Bragg 2689):

> Guayule has very little commercial potential in the wild due to the fact that it is in some respects like oil. It is not a renewable resource because no one yet knows how to get it to revegetate in a controlled manner. Being a wild plant there is no control over its yield, its growth rate, or anything like this. In order to commercialize it, an entire new approach has to be taken in terms of stimulating growth and this type of thing, selecting high yielding plants.
>
> Jojoba up to now has only been commercial from wild plants. There are several thousand acres of domestic plantings in the ground but these have not yet reached maturity so we do not know yet what the commercial success of it is going to be.
>
> Euphorbia lathyris has not yet been planted commercially by anyone yet. We are attempting or several people are attempting to produce seeds for small trial plots (Bragg 2688–89).

366. In Mr. Bragg's opinion, it would cost $20,000/acre to plant and raise guayule for 20 years. Guayule does not produce a commercial crop for five years (Bragg 2694). As Mr. Bragg stated "there is no possibility of commercially producing guayule rubber at the present time (Bragg 2698). In Mr. Bragg's opinion, there is "an extremely high risk" in trying to commercially farm guayule on a small tract. A minimum of 100 acres and probably more would be needed to attempt to commercially farm guayule (Bragg 2700–01). There is no current **[96]** demand for guayule rubber in this country and no processing or extraction plants are in existence (Bragg 2697, 2712).

367. In Mr. Bragg's opinion, at least 100 acres is also the minimum amount needed to try to commercially farm jojoba (Bragg 2695). At the present time, there is no commercial production of jojoba. It takes approximately five years before one could expect a commercial crop and no profit for eight or nine years (Bragg 2689–96).

368. The risks involved in farming guayule, jojoba, and euphorbia include the fact that all are very difficult to grow. The plants are susceptible to being overrun by weeds, are extremely sensitive to cold

temperatures, and can be killed or damaged by temperatures below 20 degrees. Researchers have no knowledge as to how these plants will produce in a controlled environment. A grower would have no prior record for determining what problems would be encountered in terms of insects, diseases, weeds, or to know the proper pesticides or herbicides to use (Bragg 2690–91).

3. Use Of The Properties For Ranching

369. As for ranching in far West Texas, in Mr. Holtz's opinion, the minimum acreage on which an area ranch may be operated commercially would be 10,000 acres. Such acreage could support a herd of 100 head of cattle, and it is likely that one could gross $35,000, of which more than half would go for expenses. Given the low animal carrying capacity, 10,000 acres is really a small ranch, and the rancher would be receiving a relatively low salary (Holtz 3063–64).

370. There are approximately 150 operating ranches in Mr. Holtz's district. Range size varies between 5,000 to 200,000 acres. Range capacity has declined since the turn of the century. Due to overgrazing, the delicate ecology of the area has been upset, and the natural grasses have been replaced by brush. The present carrying capacity varies from between 2–14 animal units per section, depending on what the range size or soil is and the extent to which it has been depleted. The average carrying capacity is five or six animal units per section (Holtz 3057–60). In the subject properties, the carrying capacity for cattle would be 6–10 units on SWS and 6–7 units on GVA and GVA II (Harlow 2955–58).

371. Necessary costs associated with ranching in the Van Horn area include land taxes, supplemental feed, veterinary costs, pickup truck and fuel, maintenance costs as well as labor costs. Horses are also needed (Holtz 3060–61). **[97]**

372. Skills required of ranches in this area include a knowledge of supplemental feeds and carrying capacity, knowing the breeds that will do best on a particular ranch (flat or mountainous terrain), developing a water system and proper distribution system, knowing cattle diseases, and some veterinary skills since some problems may require immediate attention and many areas are remote, far from the nearest veterinarian (Holtz 3061–62).

373. The risks associated with ranching include poisonous plants and predators, such as coyotes, that can cause loss of cattle. Fire and hail can damage the range. There are disease problems, rustling problems, and drought problems. Drought is a common occurrence in the Van Horn area (Holtz 3062–63).

374. The biggest risk in ranching is the economy. Due to economic

conditions, some ranches can lay idle because of excessive costs in purchasing and raising cattle (Harlow 2963, 2965–66).

375. To raise cattle on small parcels on the subject properties would, in Mr. Holtz's opinion, probably cause a "horrendous feed cost because you are going to have to feed them everything they eat," in effect "running a miniature feed lot." Since it requires 100 acres to support a cow, the subject properties in small parcels would be too small for natural grazing purposes (Holtz 3065). Additionally, it would be necessary to build a sturdy fence and a water trough. A fence, in Mr. Holtz's opinion, would cost $2,500 a mile (Holtz 3065–66).

376. There is evidence, however, that it is possible to raise cattle on the property. Mr. Hugh Wolfe assertedly found that an irrigated pasture could support one cow per acre rather than the normal one or two cows per section (Wolfe 4545). Mr. Sanchez testified that he raises 25 cows in GVA (Sanchez 3688–89).

377. Mr. Wharton testified that he has raised cows previously (Wharton 3595). When he cleared the brush from his land in SWS he found the returning natural grasses to be sufficient to support a planned two cows on five acres (Wharton 3595–96). Mrs. Smallwood raised five or six horses on her 10 acre parcel in GVA (Smallwood 4053–54, *see* RXs 46, 47). Both Taylors have had prior experience in raising cattle (G. Taylor 4589; W. Taylor 4607). They indicated they expect to feed five or six cows and horses from the feed grain they will grow on their 47 acres in GVA (G. Taylor 4598; W. Taylor 4615). Mr. W.D. Smith also testified that by raising feed grain a person could support a cow on five acres (Smith 932). **[98]**

VI. COUNT III

378. Count III of the complaint charges respondents with unlawfully inducing payments by purchasers on lots "which are of little or no value to purchasers as an investment, homesite, farm, and for any other reasonable use. . . ." It further charges respondents with unlawful reception and retention of purchasers' money (par. 15).

A. *The Value Of The Properties*

1. Complaint Counsel's Experts

379. Mr. E.T. Compere, Jr., a real estate appraiser, testified in support of the complaint.[67] He attended Hardin-Simmons University

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[67] Mrs. Martha Conoly, the only active real estate broker in Culberson County, testified that in her opinion the value of land in SWS would be $70 per acre, and the value of the land in GVA and GVA II would be $50–$70 an acre. Since respondents' properties, as they presently exist, are all raw, undeveloped ranch land, that would be its value (Conoly 1035–41, 1057–59). While Mrs. Conoly has been a long time resident of the Van Horn area, she admittedly is not a qualified appraiser (Conoly 1041). Because complaint counsel's primary reliance for appraisal testimony is upon Mr. Compere, the appraisal testimony of Mrs. Conoly will be given little weight.

In any event, there is the testimony of Mrs. Conoly that there is no local demand for tracts outside Van Horn

(footnote cont'd)

in Abilene, Texas, and furthered his education at Columbia University in New York in 1947, receiving a Bachelor of Science degree in the School of Business. He testified that he had been in the appraisal business with the firm of Compere and Compere of Abilene, Texas for 34 years. He has previously testified as an appraisal expert some 50 to 60 times, both on behalf of private parties (including subdividers of undeveloped land) and governmental agencies. Mr. Compere has [99] worked extensively in the five county West Texas area encompassing, and adjacent to, the subject properties (Culberson, Jeff Davis, Presidio, Hudspeth, and Brewster Counties). Mr. Compere has appraised both large and small tract rural lots. For example, one ranch he appraised in Presidio County totaled 100,000 acres. Another piece of property in New Mexico was also 100,000 acres, and one he appraised in El Paso County totaled 40,000 acres. Mr. Compere has also himself subdivided land in Abilene, and on lake property near Brownwood, Texas (Compere 3161–74).

380. Mr. Compere has been a member of the American Institute of Real Estate Appraisers (AIREA) since 1954. He is a senior member of the Society of Real Estate Appraisers (SREA); past president of the West Texas-New Mexico chapter of AIREA; past president of the Texas Real Estate Association; past director of the National Association of Real Estate Boards; past president of the Abilene Board of Realtors; and has been on the faculty of AIREA and SREA. Mr. Compere has taught real estate appraisal courses for AIREA and SREA from 1956 to the present. He also teaches real estate appraisal courses at Hardin-Simmons University. Mr. Compere is a past international governor of SREA, and a member of the governing council of AIREA (Compere 3166, 75–76).

381. Mr. Compere was asked by complaint counsel to appraise the value of the respondents' three properties, SWS, GVA, and GVA II; to make a study of the economic area in which they were located; and to arrive at a value of a typical tract in each subdivision (Compere 3190–91). Assisting Mr. Compere was Mr. Tom Bennett, an employee of Compere and Compere.

382. Mr. Bennett's qualifications were listed in the record as follows: He received his Bachelor of Science degree in Accounting from Tarleton State University, Stephenville, Texas, in 1973; his Master of Business Administration degree in 1976. Mr. Bennett was reported to have been a full-time appraisal instructor and real estate finance instructor at Clark County Community College from 1976 to 1979, and an appraisal instructor at Hardin-Simmons University in 1980.

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smaller than 320 acres (Conoly 1092). On further examination, however, she acknowledged that there were two 20 acre tracts outside Van Horn which were sold some years ago for $500/acre (Conoly 1093–94). There was other testimony concerning demand for small acreage tracts near Van Horn (Sanchez 3686–88; Smallwood 4052–55; Mitchell 3733; W. Bray 3802; H. Bray 4009; Wolfe 4554).

He has worked as a full-time appraiser for Compere and Compere since January 1980, and has successfully completed a number of real estate courses offered by AIREA in pursuit of his designation as an MAI (Member of the Appraisal Institute) (Compere 3192–95; *see* CX 436, p. 223).

383. Mr. Compere defined a number of terms which he later used in his testimony. The term "market value" he defined as the price that a willing seller would take and a willing buyer would pay for a piece of property, neither party being under pressure to buy or sell; both fully informed; and allowing for a reasonable time for the transaction (Compere 3182). **[100]**

384. The term "market approach" he defined as one approach to estimating value. This involves finding sales of property comparable to, or closely comparable to, the property to be appraised, analyzing those sales, and arriving at an indication of value based on what such comparable properties are selling for (Compere 3186).

385. "Comparables" refer to properties similar to the subject property in terms of location, soil, topography, and size (Compere 3187–88).

386. The phrase "highest and best use" the witness defined as that use the subject property will most likely be used for; that would produce the greatest net return over a given period of time; and that use that is most likely to occur (Compere 3188).

387. The term "economic unit" he defined as the number of acres of a rural area that would be required for a typical family to derive a living from (Compere 3189).

388. The term "promotional value" was used by Mr. Compere in connection with properties primarily in subdivisions where sales are for low down payments with large amounts of the sales price carried back by the seller; and where promotional costs constitute a considerable amount of the down payment (Compere 3188). Mr. Compere also referred to "promotional value" as being that value obtainable in a limited market by the use of high-pressure sales tactics and primarily geared to absentee owners (Compere 3521).

389. In arriving at his appraisal value of the subject properties, Mr. Compere and Mr. Bennett visited the lands in September 1980, with Mr. Bennett returning the following month. Upon his return, Mr. Bennett also went to abstract offices to obtain sales information about comparable properties; visited Sul Ross University to gather economic data about the area; interviewed Soil Conservation Service personnel; visited Texas A&M Experimental Stations in the area; inspected other subdivisions in the area; contacted real estate brokers, bankers, and savings and loan institutions; and also farmers, ranchers, and drillers. Mr. Compere attempted to obtain from abstractors informa-

tion concerning sales of tracts within other subdivisions, and all of the sales for the past eight or ten years of large tracts sold in the five-county area, as well as sales of small tracts of non-subdivided lands. Mr. Compere and Mr. Bennett also reviewed water studies of the relevant area prepared by Ed Reed and Associates, and reports by the U.S. Geological Survey. They reviewed brochures, fact sheets, **[101]** contract forms, and other sales materials of the respondents, and information regarding resales of land in the subject properties (Compere 3195–3208, 3510).

390. In arriving at his appraisal value of the subject properties, Mr. Compere used the market data approach because, in his opinion, there were enough market transactions to arrive at a fair value of the properties. The five-county area was used because, based on his research, these are generally regarded as very similar in terms of population, soil, topography, climate, and rainfall. The population of Culberson County in 1970 was 3,429 as compared to 3,319 in 1980, a decline of 3.2%. For the entire five-county area, the population was 19,970 in 1970 and 20,462 in 1980, an increase of 2.5%. The approximate physical size of the five county area is 20,760 square miles or 13,286,400 acres. This, the witness noted, is slightly larger than the combined size of the states of New Jersey, Maryland, Delaware, and Rhode Island. According to Mr. Compere, there is enough acreage in the five-county area for each person currently living there to occupy one square mile.

391. The predominate use of the land in the five-county area is for farming and ranching. In Brewster County, 64% of the total land area is in farm and ranch use. The median size of a farm or ranch there is 26,976 acres, and 99% of the total agricultural products sold are allocable to livestock and live stock products. In Culberson County, which contains 2,426,660 acres, 29,567 of these were in crop land, 26% of which was irrigated. The median size of a farm or ranch in Culberson County was 22,246 acres in 1977, and livestock and livestock products accounted for 56% of total agricultural receipts. In Hudspeth County, the average size farm or ranch was 15,054 acres, 51% of total income from farming and ranching was attributable to livestock and livestock products. The median size farm or ranch in Jeff Davis County was 23,102 acres, and 96% of total acreage was in range land. In Presidio County, the average size farm and ranch was 15,405 acres, with 78% of total revenues from farming and ranching attributable to livestock and livestock products (Compere 3238–40).

392. In Mr. Compere's opinion, the highest and best use of the subject properties is for range land. He based his opinion on the fact that this is what other land in the five-county area is being used for; the fact that in addition to selling lots the subject properties are

currently being used for cattle grazing; and the fact that he could find very few resales of any of the subject properties on a person-to-person basis, rather than on a promotional basis (Compere 3241–42).

393. In Mr. Compere's opinion, the number of acres that would constitute an economic unit for ranching purposes would be 6,400 acres. This opinion he based on discussions with **[102]** agricultural experts in the area, and the Texas A&M extension service. Such acreage he believed would support 4–10 animal units per section. The 6,400 acres would allow a family to support itself from a ranching operation. While the 6,400 acre figure is smaller than the average size ranch in the five-county area, it represents the minimum number of acres needed to generate an income to support a family (Compere 3242–43).

394. Mr. Compere considered farming as a possible highest and best use of the properties. However, because of the relatively small amount of the total land currently being used as farmland in Culberson County, and in view of the costs involved, especially in irrigation, he did not deem it as the highest and best use (Compere 3246–47).

395. In arriving at a value determination, Compere gathered sales information regarding large tracts (413 to 103,000 acres), small non-subdivision tracts (under 413 acres), and subdivision tracts (160 acres and under). There were 50 large tract comparables used, 20 small non-subdivisions, and 13 subdivision sales (CX 436).

396. In all, he found 31 subdivisions to exist in the five-county area (although he could not physically locate or visit some of these). Mr. Compere examined these subdivisions to determine if there was a market for such properties on a resale basis. Mr. Compere determined that the subdivision sales did not meet the definition of fair market value because "normal" financing was not used; there were few face-to-face dealings; and promotional value elements were present. Additionally, he found that abstractors could not locate any recorded resales from the original purchaser to a subsequent purchaser. Only four recorded deeds were found for the subject properties. The witness explained that those sales were not used in arriving at a value determination because of the same reasons that other subdivision sales were not used.

397. In preparing a statistical analysis of other subdivision sales, Mr. Compere came to believe that the standard deviation was so great that the price seemed to depend on the type of promotion being carried on rather than being a reflection of market value. He found few, if any, realtors who would list such subdivisions for resale because of the lack of demand. For these reasons, he did not use small subdivision sales as comparables (Compere 3211–12, 3252–62). Subdivision sales are listed in CX 436 pp. 42–54 (Compere 3264).

398. Mr. Compere estimated the value of each of the subject properties both as a whole and in small size parcels (five, ten, twenty, and forty acres). Mr. Compere gathered sales data regarding 50 large parcels (*see* CX 436 pp. 58–108). From these, **[103]** he and Mr. Bennett selected nine as most comparable to SWS as a whole, 11 for GVA as a whole, and 12 for GVA II as a whole. According to the witness, the selected large tract parcels were most similar to the subject properties in terms of size, location, access, topography, and soil. An adjustment was made for the time of purchase (Compere 3265–74; CX 436 pp. 58–108, 140–44, 166–70, 193–97).

399. With regard to the subject properties in small size tracts, Mr. Compere and Mr. Bennett gathered sales information on twenty potential comparables (*see* CX 436, pp. 109–28). From these Mr. Compere and Mr. Bennett selected five tracts as most similar to SWS and GVA, and nine as most similar to GVA II. According to the witness, these parcels were most similar in terms of size, location, access, topography, and soil. Adjustments were made for time, size, and location (Compere 3269–74; *see* CX 436 pp. 146–48, 172–75, 209–11).

400. Mr. Compere thereafter arrived at his final value determinations regarding the subject properties. In his opinion, the values of each of the subject properties as a whole and in individual lots as of the following dates are as follows (Compere 3226–30, 3275):

January 1, 1974
Southwest Sunsites

1. 17,467 acres at $35 per acre or $610,000 (rounded).
2. Individual tracts (lots) from $54 to $62 per acre.

January 1, 1976
Green Valley Acres

1. 15,000.227 acres at $50 per acre or $750,000 (rounded).
2. Individual tracts (lots) from $55 to $62 per acre.

January 1, 1977
Green Valley Acres II

1. 9,611.002 acres at $60 per acre or $575,000 (rounded).
2. Individual tracts (lots) from $90 to $110 per acre.

July 1, 1980
Southwest Sunsites

1. 17,467 acres at $60 per acre or $1,050,000 (rounded).
2. Individual tracts (lots) from $90 to $110 per acre. **[104]**

July 1, 1980
Green Valley Acres

1. 15,000.227 acres at $65 per acre or $975,000 (rounded).

2. Individual tracts (lots) from $70 to $95 per acre.

July 1, 1980

Green Valley Acres II

1. 9,611.002 acres at $80 per acre or $770,000 (rounded).
2. Individual tracts (lots) from $70 to $110 per acre.

401. Although the value Mr. Compere arrived at for small tracts is somewhat higher than for the property as a whole, he considered the highest and best use of the large tracts to be for ranching purposes. The sales of small tracts do show that some, but not all, of the subject properties could sell at a slightly higher price than if the lots were sold in large tracts. Such lots he considered would be used as homesites, and not used for the highest and best use, ranching (Compere 3275–77, 3438). In Mr. Compere's opinion, the subject properties are not a good commercial investment for the highest and best use.

2. Respondent's Attack Upon Mr. Compere's Testimony

402. Respondents contend that Mr. Compere's testimony is permeated with serious errors.

403. Respondents assert that the assignment given to Mr. Compere was simple and unambiguous, *viz.*, that he was instructed to determine "the value and usability" of the "lots" in each of the three subdivisions (RX 14; Compere 3342). Nonetheless, it appears that Mr. Compere also analyzed the fair market value of the entire tracts (CX 436 page 144, 154, 170, 180, 197, 207). Respondents claim that in beginning his analysis with the full properties, 8,611 to 17,467 acres each, Mr. Compere was impelled to the erroneous conclusions that the highest and best use of the property was for ranchland (Compere 3241–42), and that this conclusion was based upon the fact that other properties of comparable size were used as ranches (Compere 3238–40). Respondents further note that Mr. Compere also concluded, based upon some studies by the Texas A&M Extension Service, that the economic unit for ranch use is 6,400 **[105]** acres (Compere 3242). Respondents do not challenge either of these two conclusions as applied to large tracts of rural land. The problem assertedly arose when Mr. Compere sought to impose these conclusions upon properties of 5 to 40 acres in size.

404. In this regard, Mr. Compere concluded that the highest and best use of tracts of 5 to 40 acres is the same as the highest and best use of 8,600 to 17,000 acre tracts, *viz.*, the highest and best use in ranchland (Compere 3242–47). Respondents argue that in light of his conclusion that it takes 64 acres to raise a cow and a calf, and that it takes 6400 acres to raise sufficient cattle to support a family (Com-

pere 3242–44), it is obviously an error to conclude that the most likely use or the most profitable use of a 5 to 40 acre tract is a ranch.

405. Respondents also point out that Mr. Compere admitted that Texas A&M, the University of Texas at El Paso, Sul Ross University and the West Texas Council of Governments, among others, had prepared economic studies showing that a 5 to 40 acre tract of land in West Texas can be "a viable economic unit" (Compere 3471). He listed numerous ventures which could return enough profit on small acreage tracts to support a family: fish farm, shrimp farm, pecan orchard, grape vineyard, ornamental cactus farming, and greenhouse tomatoes (Compere 3471). Nevertheless, he rejected these alternatives and found that the highest and best use of respondents' properties was for grazing, a use he deemed impossible on small parcels (Compere 3472).

406. In addition to the above, respondents complain of alleged numerous errors in, *inter alia*, Mr. Compere's data collection efforts, and his selection of "comparables" (RPF 163–88).

3. Respondents' Experts

407. To counter the appraisal testimony offered by complaint counsel, respondents offered the testimony of Messrs. Larry Brooks and Blake Maddox.

408. Mr. Brooks identified himself as a real estate appraiser and consultant. He has been an appraiser for nine years, and is now the president and managing partner of Brooks, Lomax and Associates, at which he supervises twelve appraisers (Brooks 4296–98).

409. In 1976, Mr. Brooks received the SRPA designation, which stands for senior real property appraiser (Brooks 4300). Two years later he was designated MAI, Member of the Appraisal **[106]** Institute (Brooks 4301). He was the youngest person ever to receive the SREA designation in 1980, indicating that he is a member of the Society of Real Estate Appraisers (Brooks 4302). He is a member of the West Texas-New Mexico Chapter of the American Institute of Real Estate Appraisers (Brooks 4308).

410. Mr. Brooks testified that he has conducted 4,000 to 5,000 appraisals of all types of property, primarily in Texas, New Mexico, Arizona and Colorado (Brooks 4303–04). Included among these appraisals are approximately 25 appraisals of rural subdivisions (Brooks 4305). He has appraised land for the Federal Home Loan Bank Board, General Services Administration, the Department of Interior and the Department of Labor (Brooks 4305–06). He did some of the field work for the Department of Justice in the criminal action against Amrep Corporation (Brooks 4506). He has also done appraisals for numerous state and local governments, including the City of Albuquerque, the

City of Sante Fe, Bernalillo County, and the Municipal Redevelopment Agency (Brooks 4307). He was currently appraising a 1,000 acre rural recreation subdivision in southeastern New Mexico for the Federal Home Loan Bank Board (Brooks 4306).

411. Mr. Brooks has testified an an expert appraiser approximately ten times, in Bankruptcy Court, District Court of the State of New Mexico, and some administrative agencies (Brooks 4307).

412. Mr. Brooks taught the principles and practice of real estate appraisal in 1978 and 1979 at the University of Albuquerque (Brooks 4308). He has lectured and sat on approximately ten seminar panels at various symposia of the SREA (Brooks 4308).

413. The first step in Mr. Brooks' appraisal was to collect information on a five-county area in West Texas, including Culberson, Jeff Davis, Hudspeth, Brewster and Presidio Counties, and about the subject properties themselves (Brooks 4320). Much of the collection of this and other data was carried out by an appraiser-associate working with Brooks, Lomax & Associates, named Blake Maddox (Brooks 4320; Maddox 4215–16). Mr. Brooks also had access to the property fact sheets, Mr. Compere's written report, and the hydrology reports prepared for the properties (Brooks 4320–21). He personally visited the Soil Conservation Service in Van Horn, the county agriculture extension agent and the Van Horn Chamber of Commerce (Brooks 4321).[68] He also obtained various government and university **[107]** soil tests and water reports, and a report by Texas A&M on farming and crops (Brooks 4321). He visited the three properties early in his preparation (Brooks 4322).

414. After this initial collection of information, Mr. Maddox returned to the five-county area to collect the same types of information, but in greater detail (Brooks 4322). Mr. Maddox also researched deed records in the five counties to find recorded sales of tracts of land of 100 to 120 acres in size or smaller which had been transacted from 1978 to 1981 (Brooks 4359–60; Maddox 4238–39).

415. The appraisal technique used by Mr. Brooks was to find comparable properties which had been sold in similar sized tracts in recent years (Brooks 4304). He determined the value of the comparable properties, and uses those values to calculate the fair market value of the subject properties, which is essentially the same technique employed by Mr. Compere.

416. Mr. Brooks inspected U.S. Properties, the subdivision owned by Mr. and Mrs. Bray which adjoins SWS on its northwestern border (Brooks 4330; W. Bray 3776–81; RX 69). Since the tracts in U.S. Properties were immediately contiguous to SWS, identically sized, with

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[68] Mr. Maddox also interviewed two employees from the Soil Conservation Service and the county agriculture extension agent (Maddox 4258).

identical characteristics, and sold during the same time period, Mr. Brooks determined that they would be ideal comparables, if he could establish that they were arm's length sales meeting the definition of fair market value (Brooks 4331–32). Mr. Brooks therefore met with Mr. and Mrs. Bray to determine from them the manner in which they sold their properties and to obtain from them a list of purchasers (Brooks 4332; Maddox 4226). He then developed a telephone survey designed to confirm the information provided by the Brays, and to determine if the sales of U.S. Properties were market value transactions (Brooks 4332; Maddox 4234; RX 78).

417. Each of the purchasers of U.S. Properties who could be reached by telephone was surveyed (Brooks 4345). Messrs. Brooks and Maddox were able to contact approximately 13 of the 60 purchasers of U.S. Properties (Brooks 4345). Mr. Brooks concluded that these sales of U.S. Properties were market value transactions, meaning that they met the market value definition and thus were valid indicators of market value (Brooks 4346).

418. The approximately 47 customers of U.S. Properties not surveyed by telephone were mailed a written version of the survey (Brooks 4348). About 25% to 30% of these customers responded (Brooks 4349; RX 80; RX 81). **[108]**

419. The mail survey was also sent to purchasers of Terlingua Ranch, another potentially comparable subdivision in West Texas (Brooks 4352).[69] Responses were received from approximately 25% of the Terlingua Ranch purchasers (Brooks 4367). A second mail survey, RX 79, was mailed to all purchasers of potentially comparable land whose names had been obtained from the deed records in the courthouse in the five counties (Brooks 4351–52). This survey was sent to every recorded purchaser of small acreage in the five counties since 1978 for whom an address was found, about 240 persons (Brooks 4361). Surveys were not sent to the approximately 110 purchasers for whom no address was available (Brooks 4361).

420. Mr. Brooks received about 75 completed surveys, a response rate of slightly less than 33% of the 240 mailed out (Brooks 4362–63). Mr. Brooks's opinion is that for appraisal purposes, the response rates on all three surveys were sufficient (Brooks 4367).

421. Following the surveys, Mr. Brooks returned to the five-county area for the purpose of making an on-site inspection of the potentially comparable properties (Brooks 4367–69).

422. Following these efforts, Brooks determined that the best indicator of value for the subject properties was U.S. Properties (Brooks 4369, 4402–03). This determination was based on the physical proximity of the properties, the number of transactions, the established

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[69] Terlingua Ranch was described by Mr. Blake Maddox at 4265–68.

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pattern of sales, and, most importantly, the similarity in sizes of the parcels (Brooks 4369–70, 4372).

423. Mr. Brooks testified that he also relied upon person-to-person resales of land in Terlingua Ranch, which he determined to be comparable to respondents' properties (Brooks 4370, 4372). He had obtained through the mail survey of these purchasers information sufficient to persuade him that these sales were also indicative of market value (Brooks 4370).

424. After the comparables were identified and tabulated, it became necessary to compare them to the subject properties and make whatever adjustments were necessary (Brooks 4372–73). The adjustments are shown on RX 84 and RX 85. The first adjustment was to convert the total sales price into a price per **[109]** acre, not only to have a uniform standard of value, but because Mr. Brooks' research indicated that undeveloped rural acreage is bought and sold on a price per acre basis (Brooks 4376).

425. The second adjustment was for time, to determine the value as of July 1980 (Brooks 4376). Mr. Brooks used a paired sales analysis (*i.e.*, analysis of two identical properties sold for different prices at different times) to determine that land values were increasing at a rate of about one-half percent per month (Brooks 4377, 4379–82). Sales prices of the comparable properties were increased or decreased, as appropriate, at a rate of one-half percent per month to find the value as of July 1980 (Brooks 4377–78, 4382–83).

426. Mr. Brooks next adjusted the Terlingua Ranch sales for size, finding that in rural properties the price per acre increases as the size decreases (Brooks 4382–84).

427. Mr. Brooks did not make a size adjustment with respect to most of the U.S. Properties sales (Brooks 4403–04). The reason is that there were sufficient U.S. Properties sales in each of the relevant sizes to permit analysis without size adjustments (Brooks 4403–04). Mr. Brooks did make a size adjustment for the 40 acre parcels, because there were too few 40 acre sales in U.S. Properties to establish value without considering properties of other sizes (Brooks 4406).

428. The final step in Mr. Brooks' appraisal was to reconcile the information to achieve a value determination for the subject properties (Brooks 4408–09). As part of this process, he determined that the values in the three properties were the same (Brooks 4410).

429. Mr. Brooks' appraisal conclusion are that as of July 1980, a five acre parcel had a value of $525 per acre, a ten acre parcel had a value of $475 per acre, 20 acres were valued at $375 per acre, and a 40 acre parcel was $275 per acre (Brooks 4411).

B. *Respondents' Retention Of Money*

430. The record is clear that customers of respondents had ample opportunities to receive refunds. The contracts accord customers of all three properties the right to visit the property within 60 days and request a refund for any reason (Gross 461; Kritzler 4110, CXs 74, 75, 76, 77, 78):

> Purchaser shall have 60 days from the consummation date of this contract to [110] make a registered personal inspection of his property on a company-guided tour, and have all moneys paid to Seller refunded if he is not satisfied in any way, provided Seller is so notified at the time of the initial inspection, on a form provided by Seller, and provided that Purchaser is current in his payments hereunder. This provision shall not apply to property purchased while On-Site or subsequent to a visit to the property, and cannot be exercised by an agent on behalf of purchaser.

431. Forms were provided to each purchaser who visited, giving him the option to receive a refund (RXs 70, 71, 72, 73).

432. There was testimony that when a customer sought a refund on a visit, it was "automatically" granted (Gross 463; Novaez 892, 902). The purchaser was not required to give a reason for requesting his refund (Novaez 892–93).

433. If for some reason a customer was unable to visit the property within 60 days, the record indicates that respondents were willing to extend that time period (Gross 462, Novaez 886, W.D. Smith 939, Kritzler 4110). And in instances where the customer had not sought an extension of time, it was respondents' asserted policy to nonetheless honor any exercise of the guarantee within a reasonable time (Kritzler 4111, W.D. Smith 939).

434. At least one third of the customers from Texas visited the property within the guarantee period (Novaez 896). From 1976 to 1978 about 400 purchasers visited the properties (W.D. Smith 939). It was reported that many of the people who visited the property bought more property during or after the visit (Novaez 896).

435. Mr. Ted Rose, the former sales manager for the Houston and Dallas offices, testified that he telephoned every customer of his new sales representatives to assure that the sales presentations were fair and accurate (Rose 678, 701). After a sales representative became more experienced, it was Mr. Rose's policy to continue to telephone his customers on a spot check basis (Rose 701). If a problem was discovered in any sales, Mr. Rose testified that he would return the downpayment and refuse to process the contract (Rose 719). [111]

436. During the last year before sales were terminated, respondents hired Mr. Jeffrey Elfont to verify sales. Beginning in February 1977 Elfont attempted to telephone every purchaser of the three properties (Elfont 4168). After about three months, Mr. Elfont discontinued call-

ing customers of respondents' in-house employees, because he had found during those three months that the employee sales raised no problems (Elfont 4169). He telephoned every purchaser of respondents' hired brokers until Diversified Realty was terminated in February 1978 and Porter Realty in March 1978 (Elfont 4188).

437. Witnesses attested to receiving these calls (Schlachter 2118, Swanson 2478). In other instances, Elfont's records evidence that the customers were contacted (Elfont 4171–74; RX 61 (Schlachter), RX 62 (Sweets), RX 63 (Lueckel)).

438. Mr. Elfont testified that he questioned each customer about the content of the sale presentation, especially about whether any statements had been made about investment or oil potential, the receipt of the fact sheet, and the customer's understanding of water and utilities (Elfont 4176, 4191, 4193–94).

439. In those instances where Elfont believed that the sales might have been transacted in a manner violative of company policy, he referred the purchaser's name to Mr. Kritzler. Mr. Kritzler then reportedly telephoned the customer, and either resolved the complaint to the customer's satisfaction or offered the customer a refund (Kritzler 638–40, 4118–23, Elfont 4178, 4181, 4182, 4186). [112]

Discussion

There is no need for an extended discussion of this matter. The evidence, in my view, simply does not prove the charges.

A. *Count I*

Count I presents the question of whether respondents falsely represented their properties as being good investments, involving little or no financial risk to purchasers. I have examined the evidence in the record, and must conclude that the preponderance is in favor of the respondents.

Concerning respondents' TV and radio advertising, primarily in Houston and Dallas, numerous examples of these messages are found in this record. Finding 59 identifies them to be CXs 42 through 71 and CX 395. Finding 60 states as follows:

> 60. I have examined these materials and can find no reference in them, with one or two possible exceptions, to investment or accompanying financial risk. While the point is emphasized that the offered price is affordable, the messages are all oriented toward the uses which may be made of the land by purchasers, not resale profitability. Over and over again the theme is repeated: *viz.*, fertile valley; sunshine; clean air; quiet environment; mountain scenery; abundant water; farming; ranching; hunting; camping; retirement; satisfaction in owning land. While "combating inflation" is prominent in several of the scripts, it appears nearly, if not always, to be in the context of using

e property to produce one's food, thereby reducing expenses (*see* CXs 51, 52, 58, 59, 0)).

ne of these commercials, CX 58, does employ the word "investment." owever, the word is used in a context which features many of the actors referred to in Finding 60 (*see* Finding 62). [113]

Laying aside respondents' brochures for the moment, it may be bserved that there is no reference to investment or risk in any of espondents' fact sheets or contract forms (Finding 64). Nor is there nything in respondents' "picture book" or other sales aids, or post ales materials, from which purchasers may reasonably conclude that heirs was a risk-free investment (Findings 75–80).

Concerning respondents' brochures, there were representations as o investment contained in the original brochure which respondents sed for two or three months in 1974, following the purchase of the WS property. That brochure had been prepared by another company hich had previously owned the property, Southwest Land Corporaion. In composing their own brochure, respondents toned down the nvestment claims, and later deleted them altogether in composing he GVA and GVA II brochures (Findings 65–73).

Whether or not, based on the above, respondents can be held to have epresented their properties as a good investment, the consumer witesses in this case certainly did not consider their purchases to be isk-free. Virtually all of them testified that they knew at the time of heir purchase that there was no guarantee that they would profit rom the transaction (Findings 86–91, 93, 95–104, 106–07).

There is little, if any, reliable evidence which establishes that eceptive statements concerning investment were engaged in by respondents in-house salesmen (Findings 81–82). There is, however, evidence that deceptive investment statements were made to prospective urchasers on the part of employees of real estate brokers hired by espondents to sell the properties. A great deal of these representations concern the discovery or possible presence of oil (Findings 87, 88, 93, 101, 104, 106, 109, 111, 113, 115).

While much of what was represented to prospective purchasers concerning oil turned out to be at least reasonably accurate (Findings 110–122), it was respondents' stated policy not to employ representations concerning oil in their sales approach (Finding 123). When respondents' efforts to prevent these representations failed, the brokers' services were terminated (Findings 50, 54).

While I am fully aware of that line of FTC cases which hold principals liable for the misrepresentations of their agents, *e.g., Goodman* v. *FTC*, 244 F.2d 584, 592 (9th Cir. 1957, [114] there must come a point where respondent is permitted to exculpate himself. I am of the opinion that the actions taken by respondents to correct the situation, including the surveillance activities of Mr. Elfont, the liberal refund policy, and the termination of the brokers, were sufficient to place respondents beyond the reach of those cases.

B. *Count II*

The preponderance of the evidence is also in favor of respondents with respect to the charge that they falsely represented their properties as suitable for homesites, farms and ranches.

What is in issue in this case is rural, undeveloped land situated in far West Texas, 120 miles from El Paso.

Respondents do not deny that they represented their parcels as suitable for homesites, but they maintain they always disclosed to purchasers that it was up to them to arrange for their own utilities and water.

Elaborate findings have been made in this case concerning the fact that utilities were available in a practicable sense to purchasers, *viz.*, electricity (Findings 159–70); sewage disposal (Findings 177–79); propane gas (Findings 185–88).[70] Elaborate findings have also been made concerning the presence of water beneath the properties, and the drilling of water wells (Findings 189–253). I believe the record is clear that for those who wish to use their parcels as a place whereon to live, there are no insurmountable obstacles.

It appears that complaint counsel do not challenge so much the fact that utilities and water are available, as the fact that their substantial costs are not always disclosed to prospective purchasers, especially in the case of water. This is true. But the record shows that in every instance consumers were given sufficient information to permit them to inquire further, depending on their interest (*see* fact sheets, CXs 79–85). For example, if a purchaser wished to learn more precisely what would be the cost of drilling a water well on his [115] particular property, he was directed to contact well drillers in the Van Horn area.

The record also shows that for the most part, respondents fulfilled their obligations to furnish promised "improvements" to the properties, *viz.*, golf course (Findings 259–69); staking (Findings 270–76); road building and maintenance (Findings 277–88).

As for the suitability of using respondents' parcels as a farm or ranch, there is much evidence in the record. There is nothing more clear than the fact that the properties, with irrigation, will grow practically any kind of crop (Findings 297–315). It is complaint counsel's point that the small parcels under consideration are not large enough to make commercial farming feasible (Findings 316–31).

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[70] The one possible exception may be telephone service (Findings 171–76).

Whether or not this is entirely true, the record demonstrates instances where individuals have taken substantial strides towards self-sufficiency (Findings 335–55). The record also shows that while commercial ranching is not feasible on the properties (Findings 369–75), it is quite possible to maintain small numbers of cattle for personal use (Findings 376–77).

C. *Count III*

I cannot agree with the charge of Count III that the land has little or no value to purchasers, and that respondents are unlawfully retaining their money.

On the subject of value, there is conflicting information in the record furnished by appraisal experts for both parties (Compere, Findings 379–401; Brooks Findings 407–429). Mr. Compere, complaint counsel's expert, deems the highest and best use of the land to be ranch land, and places a correspondingly low value on it (Findings 392, 400). Mr. Brooks, respondents' expert, views the property as "rural recreation" land, and places a higher value on it (Brooks 4420; Finding 429).

I do not find it necessary to rely upon expert testimony, however, in order to conclude that the subject properties are not of little or no value. Unquestionably, they are of value. As demonstrated by the evidence introduced under Count II, they may feasibly be used as homesites, and at least for personal farming and ranching. **[116]**

On the question of retaining money, since respondents, in my view, did not obtain the money unlawfully, there is nothing unlawful in the retention. Nevertheless, the record shows a liberal refund policy on respondents' part (Findings 430–39).

ORDER

Finding no violation of law as charged in the complaint, I hereby ORDER that said complaint in this matter be dismissed.

OPINION OF THE COMMISSION

BY BAILEY, *Commissioner:*

This matter comes before the Commission on complaint counsel's appeal of the Administrative Law Judge's order dismissing the complaint. Because we find sufficient evidence that respondents misrepresented the investment value and potential uses of the land they sold and failed to disclose to **[2]** consumers material facts about its investment value and suitability for use, we conclude that respondents violated Section 5 of the Federal Trade Commission Act. Thus we decline to adopt the ALJ's order dismissing the complaint and issue instead this opinion and the attached Order. This opinion is the product of the Commission's independent consideration of the entire record in this case, including the transcripts of testimony, exhibits, pleadings, briefs, and the Initial Decision. The opinion contains findings of fact and conclusions of law that the Commission believes are supported by its review of the record as a whole. Where it is inconsistent with the findings and conclusions contained in this opinion, the Initial Decision is hereby set aside. The Order issued against respondents consists of those provisions deemed necessary to prohibit respondents from engaging in the misrepresentations and omissions of fact identified here and to deter respondents from similar unfair or deceptive practices in connection with any future land sales.

A summary of the Commission's proceedings and of respondents' operation and marketing approach is presented in Section I. In Section II, we focus on the practices alleged in the complaint to be unfair and deceptive as we discuss respondents' investment and land use representations and compare those representations to the record evidence about the land's investment value and suitability for various uses. This section also addresses the existence of certain material information about the land that was not disclosed to prospective [3] purchasers. The legality of respondents' representations and omissions of fact is considered in Section III, where we discuss respondents' liability under the FTC Act for practices they pursued directly and through agents hired to sell land on their behalf. The nature and scope of the Order entered against respondents is described in Section IV.

I. BACKGROUND

A. *The Commission's Proceedings*

This proceeding involves three corporate and two individual respondents.[1] Respondents Southwest Sunsites, Inc. ("SWS"), Green Valley Acres, Inc. ("GVA") and Green Valley Acres, Inc. II ("GVA II"), are land sales companies incorporated under the laws of the State of Texas. Their corporate headquarters are in California. Individual respondent Edwin Kritzler is the general manager of each of the three corporate respondents, is a vice president and director of SWS, and is responsible for the day-to-day operation of the corporate respondents as well as for general [4] policy decisions. (ID 8)[2] The other individual respondent, Sydney Gross, and members of his immediate family own all three corporate respondents. (ID 6) Gross individually and through corporations he formed had the duty to "overlook and oversee" the operations of SWS, GVA, and GVA II, and he was the "exclusive sales agent" for SWS, GVA, and GVA II. (ID 7; Gross Tr. 296, 322–24) The overlapping ownership and management of the three corporations by the individual respondents and their families and the similarity and joint nature of their operation impel us to consider their activities collectively rather than separately.

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[1] Two other respondents were named in the complaint but are no longer included in the proceeding. Respondent Porter Realty, Inc. through its president, respondent Irvin Porter, contracted to sell land for Southwest Sunsites, Green Valley Acres, and Green Valley Acres II, and both were named in the complaint. (ID 10) Pretrial proceedings concerning Irvin Porter and Porter Realty were stayed on February 25, 1981, after a consent agreement was tentatively accepted. The consent agreement is under consideration by the Commission. The term "respondents" as used in this opinion does not include Irvin Porter or Porter Realty.

At the time the Commission's complaint in this proceeding was issued, respondents were in the business of selling to the public undeveloped land in West Texas, in parcels ranging from five to forty acres. Between 1973 and 1977 respondents bought 40,000 acres of land in three tracts in Culberson County, Texas, within 30 miles of Van Horn, Texas, a town of fewer than 3,000 people. Van Horn is located 120 miles east of El Paso. Respondents marketed the parcels to the public primarily by means of agents (termed by respondents "independent brokers") and secondarily by their own sales staff. Approximately 80 percent of the parcels [5] were sold by one broker, Porter Realty, which sold the land throughout the country by telephone solicitation. (ID 45, 47) In all, about 2,600 parcels were sold from 1974 to 1979, at prices ranging from $2,995 to $6,000 for five acres, and up to about $10,000 for forty acres.

The Commission's complaint issued on April 29, 1980, and alleged that respondents' land sales activities violated Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45 (1982).[3] In brief, the three counts charged that respondents (1) misrepresented that the parcels sold by respondents were good investments involving little or no financial risk and failed to disclose material information regarding their financial risk; (2) misrepresented that the properties were suitable for use as homesites, farms, and ranches and failed to disclose material [6] facts regarding the suitability of the properties for those uses; and (3) sold parcels that were of little or no value and unfairly retained the proceeds from the sales.

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[2] The following abbreviations will be used in this opinion:

ID – Initial Decision finding number
ID pp. – Initial Decision page number
Tr. – Transcript page number
CX – Complaint Counsel's exhibit
RX – Respondents' exhibit
CCAB – Complaint Counsel's appeal brief
RAB – Respondents' appeal brief
CCRB – Complaint Counsel's reply brief
Rec. – Record page number

[3] On April 9, 1980, the Commission initiated an action for a preliminary injunction against respondents under TC Act Section 13(b), 15 U.S.C. 53(b) (1982), to enjoin alleged violations of the FTC Act. The action was filed in he U.S. District Court for the Northern District of Texas. The District Court issued a preliminary injunction on Iay 19, 1980, restraining the respondents from further violations of Section 5, but the court declined to grant equested ancillary relief in the form of an order to prohibit respondents from continuing to accept payments on he purchase agreements and from dissipating corporate assets. *FTC v. Southwest Sunsites, Inc.*, No. 3-80-0258-F N.D. Tex. May 19, 1980). The injunction prohibiting violations of Section 5 was affirmed by the U.S. Court of ppeals for the Fifth Circuit. The Fifth Circuit reversed the district court's conclusion that ancillary relief to freeze orporate assets could not be ordered in a Section 13(b) proceeding, and remanded the case to the District Court o determine the appropriateness of granting the requested ancillary relief. *FTC v. Southwest Sunsites, Inc.*, 665 .2d 711 (5th Cir.), *cert. denied*, 456 U.S. 973 (1982).

Adjudicative hearings in this case began in Dallas, Texas, on April 13, 1981, and continued until November 1981 both in Dallas and in Van Horn, Texas, in Albuquerque, New Mexico, and in Washington, D.C. The Administrative Law Judge (ALJ) filed his Initial Decision on July 29, 1982, dismissing the complaint. On Count I, the ALJ determined that while brokers retained by the respondents, primarily Porter Realty, misrepresented the investment value of the subject properties, the respondents themselves were not liable for the misrepresentations because the ALJ believed that the respondents took sufficient action to prevent them. (ID pp. 112–14) The ALJ found that no "insurmountable obstacles" prevented use of the parcels as homesites, and that some individuals were taking "substantial strides towards self-sufficiency by farming or raising small numbers of cattle," so that he found no violation of law under Count II. (ID pp. 114–15) The ALJ also concluded that information relating to the costs of development was disclosed sufficiently to consumers so that no failure to disclose information had been proved under Count II. Finally, with respect to Count III, he determined that the land was not of little or no value, and therefore that retention of money paid for the land was not unfair. [7]

Complaint counsel filed a timely appeal from the Initial Decision and after full briefing of the factual and legal issues on appeal the Commission heard oral argument.

B. *The Land*

Respondents SWS, GVA, and GVA II all engaged in the marketing and sale, primarily to out-of-state purchasers, of undeveloped land in rural areas in West Texas. The area of Texas within which the land is located is relatively arid, with ten inches of rainfall annually on average. (Holtz Tr. 3035) Respondents' property is near desert in condition. (Drew Tr. 742; W.D. Smith Tr. 911) The predominant use of land in the county in which the subject properties are located is commercial ranching, since most land, including the subject properties, is covered with native grasses or brush. (Holtz Tr. 3035; Compere Tr. 3241) The subject properties themselves are undeveloped, generally flat land with sparse vegetation and grasses.[4]

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[4] Several photographs of the properties, offered by complaint counsel and by respondents, are included in the record. (*See* CX 436 (photographs included in appraisal report of complaint counsel's expert witness); RXs 26–48 (including photographs of neighboring land))

In 1973 respondents purchased 17,467 acres of land about 10 to 20 miles east of Van Horn, Texas, that became SWS. Respondents paid $469,857.50, or an average price of approximately $27 per acre for this property. (ID 13 & n.3) From 1968 until shortly before respondents bought it, 2,000 acres of land in the property that became SWS were sold to the public by Southwest Land Corporation, which apparently was not connected [8] with SWS. (Kritzler Tr. 647) After Southwest Land Corporation declared bankruptcy in 1973, the land was repossessed by its previous owner and sold to SWS. Respondents divided the property into 1,800 parcels ranging from five to forty acres (ID 17) and sold to the public between 1,300 and 1,595 parcels at prices ranging from $2,995 to $3,495 for five acres, which is about $600 to $700 per acre. (Kritzler Tr. 487, 481–82)

The property that became GVA (18 to 25 miles south of Van Horn) was acquired by respondents in 1976 for $750,000, or an average price per acre of $50. (ID 19 n.9) Roughly 15,000 acres were purchased and divided by respondents into 1,200 parcels. Approximately 750 to 930 lots were sold in GVA at $4,000 to $6,000 for a five-acre parcel, which is about $800 to $1,200 per acre. (Kritzler Tr. 488–90) The 9,611 acres that became GVA II, which is adjacent to GVA, were acquired by respondents in 1977 for $602,000, an average price of $63 per acre. GVA II was divided by respondents into 800 parcels. Approximately 550 lots were sold in GVA II for $4,995 to $6,000 for a five-acre parcel, which is about $1,000 to $1,200 per acre. (Kritzler Tr. 491–93) Sales were continued in each property to some extent until at least 1979.[5] [9]

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[5] The record is not entirely clear as to whether respondents are still selling property in GVA and GVA II, although sales in SWS appear to have ended. In their appeal brief, respondents state that "[t]he evidence . . . shows that as of early 1978 respondents virtually ceased all sales," citing Kritzler Tr. 637, 4126, 4127, 4153–54; Elfont Tr. 4168, 4170, 4188. (RAB 59) The pages in the transcript to which respondents draw our attention, however, do not support their proposition unless we interpret "virtually ceased" to mean only that sales through brokers ceased in 1978. Kritzler testified that respondents did not use telephone brokers to sell in the properties after 1978; he did not say that respondents stopped selling land themselves. (Tr. 637) Kritzler also testified that he "terminated" Porter Realty and Diversified Realty in 1978, but again he did not say that respondents stopped selling land themselves, only that they did not hire new brokers. (Tr. 4126–27) His testimony states that respondents stopped making sales in SWS in 1978, but sales in GVA and GVA II were not mentioned. (Tr. 4153–54) Elfont's testimony states that in 1977 only 20 parcels were sold in SWS that he reviewed; sales in GVA and GVA II were not mentioned, though he noted that Porter Realty and Diversified stopped making sales. (Tr. 4168, 4170, 4188)

Although Kritzler testified in April 1981 that no sales "in any acreage" had been made in three years, *id.* at 489–90, that clearly is not the case, since there is ample evidence of sales after April 1978, albeit not at the levels of 1977. In fact, 56 parcels in SWS were sold from November 1, 1978, through October 31, 1979, (CX 13D) 24 parcels in GVA were sold from October 1, 1978, through September 30, 1979, and 52 parcels in GVA II were sold from December 1, 1978, through November 31, 1979. (CX 30D)

Gross stated at trial that the business of SWS "at the present time" was "collecting its contracts from previous sales" (Gross Tr. 297) When asked what "is" the business of GVA, he stated that "it owns property and sells land," and as to GVA II he stated it "sells property." (Gross Tr. 298)

While it is not clear whether GVA and GVA II are still selling property to new customers or selling additional parcels to existing customers, they are, like SWS, still collecting funds under purchase agreements entered into earlier.

C. *Marketing Structure*

The manner in which the respondents sold land in each of the three tracts is relatively uncomplicated. A total of about 2,600 parcels at the three locations were sold by respondents. (Kritzler Tr. 481, 490, 492) Most sales were made by one of two brokers hired by respondents to sell the parcels, Porter Realty **[10]** and Diversified Realty.[6] Porter Realty was the single largest seller of land in the three tracts, and was responsible for up to 80 percent of sales in all three parcels. (ID 47) The respondents' own sales staff was responsible for the second largest number of sales in all three parcels. (Kritzler Tr. 591) Respondents' sales staff for SWS, GVA and GVA II included sales representatives located primarily in offices in Houston and Dallas, as well as a representative on the land, and two sales representatives who contacted, by telephone from the respondents' California offices, people who had already bought land in the respondents' properties in an effort to sell them additional parcels. Similar marketing methods were used by all three corporate respondents.

1. Sales by Respondents' Staff

Respondents opened offices in Houston in 1973 and in Dallas in 1975 to sell land in SWS, and in GVA and GVA II after those properties were acquired.[7] Respondents made initial contact with prospects through television, radio, and newspaper advertisements[8] and their sales representatives answered any [11] resulting telephone inquiries by providing some information [12] orally and attempting to set up home appointments.[9] The presentations in the home were not very detailed, and were based in large part on the printed materials that respondents either reviewed or left with potential buyers.[10] (Rose Tr. 716, 719; Hammer Tr. 660) Respondents also organized dinner parties in an effort to promote purchases by acquaintances, neighbors or relatives of people who had already bought land in the subject properties. (Novaez Tr. 883)

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[6] Diversified Realty is a Florida corporation that was not named in the complaint. Testimony from at least three consumers who bought land from respondents through Diversified Realty is included in the record. (*See* Goldstein Tr. 1714–77, Limpp Tr. 1385–435, Schlachter Tr. 2107–46)

[7] Respondents also attempted for brief periods in 1973 to sell land in SWS through offices in Atlanta and Boston.

[8] Respondents' radio and television commercials ran as often as 100 to 150 times each week during the period when sales were made. (Gross Tr. 409; Novaez Tr. 872) The record contains a number of scripts for commercials used by respondents. (CXs 42–71)

There is some dispute in the record as to whether the scripts for respondents' television and radio commercials were admitted in evidence. Respondents argue that the scripts were only "provisionally received in evidence subject to further proof of when, where and if they were broadcast" and contend further that complaint counsel failed to offer such evidence. (RAB 10 n.10) In fact, the ALJ did not receive CXs 42 to 71 on a provisional basis but received them "for what they purport to be" and "subject to further explanation." (Tr. 181) He indicated that he expected further evidence to be introduced about the scripts after which respondent's counsel could move to strike them or excise them from the record.

Prior to trial respondents admitted that the scripts in question, CXs 42 to 71, were genuine (*i.e.* not forged or altered) documents and were obtained from the files of respondents. (Rec. 1016–18) Indeed, it is significant that respondents produced these scripts to complaint counsel in response to investigational subpoenas issued in 1976 and 1978 and under an agreement by which scripts of advertisements used in the sale and promotion of respondents' land could be provided rather than the actual commercial tapes. (Tr. 169–71) Respondents also admitted before trial that CXs 42 to 71 "were utilized as scripts for the preparation of radio and television advertisements by SWS, GVA, and GVA II in connection with the promotion, offering for sale or sale of any interest in subdivided land to members of the public." (Rec. 1634)

After the scripts were received in evidence complaint counsel elicited further information bearing on respondents' use of them in marketing. For example, Gross testified extensively about the content and meaning of various statements made in the scripts as he reviewed them (Gross Tr. 413–34) and he confirmed that statements made in some of the scripts were in fact made in some of respondents' commercials. (Gross Tr. 410–11, 416) Several other witnesses also testified that they heard respondents' advertisements and that they recalled statements made therein, some of which correspond closely to statements in the scripts. (Baldridge Tr. 806–07; Lambert Tr. 1782; Robinson Tr. 1906–07; Sowell Tr. 2504–06) Finally, the record reveals that respondents did not, as they had been invited to do, move to strike the scripts. Under these circumstances, we conclude that CXs 42 to 71 are properly in the record as evidence of radio and television commercials used by respondents in their marketing efforts.

Organized sales in the Houston and Dallas offices were terminated in 1978, apparently due to market saturation. (ID 32) In late 1978, respondents began to sell land from their home office in California to those who had already bought land in the [13] subject properties. (*See generally* ID 33–34) Buyers were sent "updates" (newspaper clippings and other materials of some purported interest to landowners) to encourage them to buy additional parcels, to encourage them to continue making payments on previously purchased land, and to assure them they had made good purchases.[11] (Gross Tr. 371–72; Kritzler Tr. 574)

Respondents did not have an organized on-site sales program, but two on-site representatives were employed consecutively from 1975 until at least 1981. (*See generally* ID 35–36) Their duties included selling land when the opportunity arose. (ID 35) One of the representatives sold "some" or "very little" land, and the other sold eight parcels. (ID 36) Some parcels were sold on-site to people who were familiar with the land from living in the area. (*See* Sanchez Tr. 3688; Perkins Tr. 4021, 4024, 4035–36)

Sales representatives who were successful in efforts to sell a parcel had the buyer sign a written purchase agreement. Except for the few on-site sales, land typically was bought before the buyers saw the property, which is several hundred miles from Houston and Dallas, although respondents allowed buyers at least 60 days to visit the property and to request a refund if they were dissatisfied. About one-third of the Dallas and Houston buyers actually visited the property. (Novaez Tr. 896) [14]

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[9] If there were scripts used for respondents' telephone presentations they are not in the record. There is no evidence that a prepared script was followed in the in-home presentation, but as one sales representative testified, there were "stock answers" to frequently raised questions. (Novaez Tr. 902)

[10] The sales representative made a presentation in a potential buyer's home with printed materials that respondents either prepared or approved. As a general rule these included color brochures (CXs 86, 87), a "fact sheet" about the property (CXs 81, 82) photographs of actor James Drury, who appeared in several commercials for respondents (CX 242), a "picture book" (CX 170), a report on the fertility of the soil at the properties (CX 220), a purchase agreement (CXs 74, 75), and a topographic map. (Hammer Tr. 657, *see also* Kritzler Tr. 533–36) Though training was relatively brief and informal, sales representatives were instructed not to deviate in their presentations to customers from the information in certain written materials. (ID 29) Respondents testified that they instructed their personnel that termination could result if unauthorized statements about the land were made. (Kritzler Tr. 519; Rose Tr. 722) It is nevertheless clear from the testimony of numerous consumer witnesses that respondents' sales representatives did not limit themselves to the generalities of their written literature but offered specific statements and predictions about the land in some conversations with consumers.

[11] The primary vehicles for these materials were property owner newsletters prepared by respondents containing reprints of news articles and montages of news article headlines. (CXs 90–95, 98–102, 106, 107, 109–13)

2. Sales by Brokers Retained by Respondents

Respondents contracted with Porter Realty, a Florida corporation, to sell land in SWS on respondents' behalf. (CX 37; Porter Tr. 2249) The contract, termed an "Agents Agreement," gave Porter Realty authority to engage in marketing and promotional activities to solicit sales of the SWS land but did not authorize the firm to execute or enter into land sales contracts on respondents' behalf, providing instead that Porter Realty represented respondents in the sale of property, negotiated sales, and then delivered such sales agreements to SWS for acceptance or rejection. The contract also restricted Porter Realty's authority to use promotional materials and representations other than those authorized by respondents. Sales efforts by Porter Realty began in June 1974 for SWS. (Gross Tr. 381)

Porter Realty also arranged for the sale of parcels in GVA and GVA II after those properties were acquired by respondents. Separate written contracts were not executed between Porter and GVA or GVA II, but the parties agreed orally that the terms of the SWS contract governed Porter's rights and responsibilities with respect to marketing those properties. (Porter Tr. 2250) Porter Realty arranged approximately $11.9 million in sales of land at SWS, GVA, and GVA II before discontinuing its relationship with respondents in early 1978, and the firm received about $2 million in commissions from respondents. (Porter Tr. 2264) The firm arranged the sale of approximately 2,150 of the 2,600 parcels sold. (ID 47) [15]

Porter Realty sold the properties for respondents solely by telephone solicitation. Sales personnel called individuals throughout the United States who had previously purchased land from either Porter Realty or from another land sales company. (Porter Tr. 2325) Scripts were used to provide information to consumers over the telephone,[12] and those prospects who expressed interest in the land were mailed a packet of information.[13] Porter Realty also gave numerous consumers copies of an oil map (CX 129), a three-page photocopied document purporting to indicate the ownership of various parcels of land in the area **[16]** surrounding GVA and GVA II.[14] The map may have been used during the entire time that Porter Realty sold GVA and GVA II property, from 1976 to early 1978.[15] When a sale was agreed to, Porter Realty mailed a letter to the potential buyer encouraging him or her to sign the enclosed Sales Agreement and to return it with a downpayment to the particular corporate respondent involved. Porter Realty selected the parcels to be sold to consumers and apparently assigned them at random.[16] **[17]**

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[12] The scripts Porter Realty's sales representatives used for their first and second telephone contacts with consumers are included in the record. (CX 123, 124 (SWS); CX 124, 125 (GVA)) The firm prepared these scripts based on information supplied by respondents and the scripts were approved orally by respondents Gross and Kritzler. (Porter Tr. 2294–95) Testimony of consumer witnesses establishes that Porter Realty's sales representatives did not confine their oral statements about the land to the points made in the telephone scripts.

[13] The information Porter Realty provided included brochures, fact sheets, and copies of the contract for sale. These materials were imprinted with the names of the corporate respondents, and were supplied to Porter Realty by respondents. (Porter Tr. 2270–71) Porter Realty also placed other materials in this packet from time to time. (Porter Tr. 2274–75, 2314–15)

The circumstances surrounding the dissolution of Porter Realty's relation with respondents in April 1978 are a matter of some dispute, as the Initial Decision recounts. (ID 48–50) Porter Realty stopped selling land directly for respondents in early 1978, although it did apparently arrange resales of consumers' property to other consumers later.

Diversified Realty, another Florida broker, was retained in 1976 by respondents to sell land in GVA and GVA II, and this firm sold the third-largest amount of land. Diversified also sold the land through telephone solicitation and, like Porter Realty, gave copies of the oil map to prospects. (Goldstein Tr. 1767; Schlacter Tr. 2121) This firm's association with respondents also ended in early 1978. A relatively small number of sales were made by a broker named Holgin, who was retained in 1978 to market GVA land to prospects in the South Pacific. (ID 56)

3. Respondents' Surveillance of Brokers

Because of respondents' asserted concerns about oil-related representations by sales representatives of its brokers, respondents hired an employee, Jeffrey Elfont, to recontact customers who had already purchased through the brokers. He worked for respondents from 1977 until the brokers were terminated in early 1978. The Initial Decision describes how Elfont telephoned customers, questioned them about whether oil representations had been made, and then informed them of the absence of oil development in the area. (ID 124) For the first six months of his employment Elfont basically verified with customers the information on their contracts and reviewed with [18] them the written promotional materials. During the later months he also inquired whether oil or resale representations had been made. (Elfont Tr. 4192–95). Though Elfont claimed to have contacted virtually all purchasers, several testified that he did not contact them. (Leuckel Tr. 1860; Sweets Tr. 1955; E. Smith Tr. 2096; Stein Tr. 2211, 2226)

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[14] In the form that the document was mailed to potential purchasers, the first page (CX 129C) indicated the location of GVA and the immediately surrounding area in the west part of Culberson County. The second page of the map (CX 129B) showed land holdings in and near Van Horn, also in the west part of the county, and listed Texaco, Inc., as owning land or mineral rights in several parcels in that section of the county. The third page of the document (CX 129A) indicated producing and inactive oil and natural gas wells in the east part of the county. The names "Texaco", "Gulf", "Skelly", "Exxon," and several other oil and gas concerns are prominent, indicating that they held mineral leases in this area of the county. Porter Realty did not obtain the oil map from respondents but acquired it directly from a map company in Texas. (Porter Tr. 2313)

[15] One consumer testified that he received the map before buying a parcel in GVA in June 1976. (Grygleski Tr. 1457; *see* CX 284 (purchase agreement)) Porter stated the map was first used in late 1976 or early 1977. (Porter Tr. 2357) John Swanson received a copy of the oil map before he purchased a GVA parcel in February 1977. (Swanson Tr. 2470) Limpp received a copy of the oil map (introduced as CX 495) before purchasing land in GVA in April 1977 from Diversified Realty. Several land holdings of Texaco and the University of Texas were circled on this copy of the map. (Limpp Tr. 1393–95)

[16] The record does not indicate whether consumers who purchased other than on-site were able or attempted to choose particular lots.

When Kritzler learned that oil representations had been made to a customer he also recontacted the customer and told him or her not to expect any benefits from oil development on the land. Where customers had purchased land for its oil production capability Kritzler claims the contract was cancelled and money refunded. (ID 125–126) A few consumers testified that they did receive refunds, one after threatening a lawsuit. (Leuckel Tr. 1842; E. Smith Tr. 2095; Limpp Tr. 1420) Other purchasers asked respondents to repurchase their lots or provide refunds and were refused, or were never offered a refund. (Bear Tr. 1127; Switaj Tr. 1315; Danskin Tr. 2454) Though Kritzler was aware for some time of complaints about oil representations involving Porter Realty personnel, he could not remember any instances in which sales made by Porter Realty were rejected. (Kritzler Tr. 598–99)

4. Terms of Sale

The purchase agreements used by the three corporate respondents (and by their brokers on their behalf) are substantially identical. (*See* CXs 74–78) To execute the purchase agreement the buyer made a small cash downpayment, usually five to ten percent of the purchase price. The balance [19] was to be paid monthly over ten years, with a seven percent finance charge.

Respondents agreed in the contracts to construct a nine-hole golf course on SWS, and to build and maintain "crowned" dirt access roads on SWS.[17] On GVA and GVA II, respondents agreed to build dirt access roads, but stated that buyers were responsible for their maintenance. No other improvements or services were promised. The agreements expressly provided that respondents maintained no program for repurchase or resale of lots on behalf of purchasers, and instead referred purchasers to independent real estate agents for this purpose.

Consumers were given 60 days under the contract terms in which to make a "personal inspection" of the property and to obtain a refund within that time if they inspected the property and were dissatisfied. The precise number of buyers who actually visited the land, which under the contract terms is a precondition to obtaining a refund, is not entirely clear. Employees of respondents who lived on the subject properties testified that a total of fewer than 500 buyers ever visited the properties. (W. Smith Tr. 939 (400 buyers visited before November 1978); Gilmore Tr. 991 (75 buyers visited after November 1978)) One of respondents' sales representatives stated that about one-third of the purchasers who bought directly from respondents in Houston or Dallas visited the property. (Novaez Tr. 896). **[20]**

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[17] Respondents did not promise to construct roads on the eastern portion of SWS known as Sunsites Ranch - Unit II. (ID 278)

II. COMPLAINT ALLEGATIONS

We next consider the allegations of the complaint by examining whether respondents represented the land as alleged in the first and second counts of the complaint, whether such representations correspond to the record evidence about the land's value and suitability for particular uses, and whether material information was omitted in respondents' promotion of the land. We also review the evidence bearing on the third count, which alleges that respondents acted unfairly be inducing consumers to make continued payments and advance payments on land of little or no value for the uses represented, and by retaining the monies paid.[18]

Our examination of what respondents said and did not say about the land they marketed, as alleged in the complaint, proceeds from the perspective of the net impression communicated to the public. *See American Home Products Corp.,* 98 F.T.C. 136, 374 (1981), *aff'd as modified,* 695 F.2d 681 (3d Cir. 1982); *Horizon Corp.,* 97 F.T.C. 464, 804 (1981). In other words, it is the overall impact of respondents' practices on consumers that we must assess. This approach is particularly appropriate in this case because most consumers received a number of materials from respondents and discussed the proposed transaction with respondents or their brokers on more than one occasion. (Morley Tr. 1343; Stein Tr. 2204–08; Swanson Tr. 2467–69). In addition, **[21]** while some of the statements respondents made to prospective purchasers orally and in their promotional materials are express misrepresentations about the land's investment value and potential use, as we discuss *infra,* in other instances the full import of respondents' message appears only when the statements made are considered in the context of other statements.[19] Because consumers' impressions were formed not by any single act or practice but by an accumulation of carefully intertwined threads, we measure the allegations of the complaint against the entire fabric of respondents' marketing practices.[20]

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[18] The legal standards under which we consider the allegations of deception and unfairness appear in Section III, *infra,* along with our analysis of how the evidence discussed in this section meets those standards.

[19] Thus written materials provided by respondents were in some instances viewed as confirming points made in oral discussions consumers had with respondents or their representatives (Limpp Tr. 1398, Goldstein Tr. 1726), and express claims may have influenced the interpretations consumers gave to implied claims. Similarly, claims that standing alone might have appeared entirely permissible, when made in the context of pervasive express and implied misrepresentations contributed to the communication of an overall misleading impression about respondents' land.

A. *Investment Representations*

In Count I of the complaint (paragraphs nine through eleven) the Commission alleged respondents represented the lots they sold as good investments at the prices at which they were offered for sale and also represented that purchase of these lots involved little or no financial risk. The complaint further charged that respondents' lots were not good investments offering little or no **[22]** financial risk at the prices at which they were sold. Finally, the complaint asserted respondents failed to disclose to prospective purchasers material facts about the riskiness of the investment, the uncertainty of the future value of the lots, and the probability that purchasers would be unable to resell their lots at or above the purchase price.

The ALJ found that with few exceptions respondents' advertisements and sales literature did not represent the land as a good or low risk investment. (ID 60, 64, 76) He also failed to identify a pattern of such representations in sales presentations by respondents' representatives. (ID 82) The ALJ agreed that investment representations were made by respondents' brokers but ruled respondents' efforts to prevent or correct them relieved respondents from liability for them. (ID pp. 113–14) Having reviewed the record evidence on these points, we conclude that the ALJ did not properly consider the net impression communicated to consumers through respondents' written and oral statements. Accordingly, the ALJ's findings in these respects are set aside.

The record evidence firmly establishes that respondents and their brokers represented the land at SWS, GVA and GVA II, at the prices at which it was sold, as a good, profitable, safe, and easily resold investment with little or no risk of loss. These representations, made to prospective purchasers in advertisements, written and graphic promotional materials, and in oral sales presentations, took three forms: (1) general assurances that land, and therefore this land in particular, is a **[23]** good investment and a good way to make money; (2) specific assurances that profits on this land could be realized in a short time frame, that purchasers could expect to double or triple their money, and that no loss would be suffered; and (3) descriptions of oil and gas activity and other potential developments in the area, as well as ecitals of residential, farming and ranching uses for the land, that nveyed the representation that the land was a good investment.

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[20] That the ideas respondents implanted in consumers' minds were to some extent communicated indirectly and through an accretion of separately stated facts does not alter their message. Indeed, by repeating the investment message in varying forms and media, respondents' approach may have been both more persuasive and less apt than a single, exaggerated, express representation to raise consumers' defenses.

1. General Investment Representations

Respondents' media advertisements, which in many instances pro- ided the first contract with prospective purchasers, raised the invest- ent theme generally through references to land as a means of aining financial independence and protecting purchasers from infla- on.[21] The same point appears more directly in respondents' written aterials. Respondents' SWS brochures acclaimed the land as offer- ig "rich" potential "for the investor" and informed consumers that ne property had undergone a "thorough analysis . . . for future poten- al" which assured **[24]** buyers of "good value."[22] (CX 86E, N, 87D, L) hough these promotional brochures were toned down in each succes- ve revision,[23] each brochure contained a variety of references to land s a valuable and safe investment and the general investment theme ever totally disappeared, even from the latest, tamest versions.

All versions of respondents' brochures highlighted the views of amous Americans on the wisdom of investment in land as the best, ne safest, the most certain and the quickest way to make a **[25]** ortune.[24] (CXs 86 to 89) These quotations expressly communicate that land is a good, safe investment. They are positioned in respondents' promotional brochures in the midst of extensive pictorial and verbal presentations of respondents' land, and they appear to have no other purpose than to supplement the information being provided to consumers about respondents' land. Phrasing these observations as universal truths about land **[26]** ownership and communicating them through the words of famous forebears does not alter the fact that the representations in form and substance apply to respondents' land and undoubtedly were intended to do so. As we observed in *AMREP Corp.*, 102 F.T.C. 1362, 1643 (1983), *petition for review filed*, No. 84-1434 (10th Cir., April 2, 1984), when representations are stated as principles of general applicability consumers may be led to believe (in the absence of any disclosure to the contrary) that those representations also apply "to the particular real estate investment opportunity being offered." In the context of respondents' orchestrated marketing materials, the commercial use of famous sayings provides not simply a general commentary on land but a specific association with respondents' land. We therefore conclude that these quotations contributed to the general investment marketing theme respondents conveyed to consumers.[25] **[27]**

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[21] One advertisement stated "[h]ere's how you can buy independence and protect yourself against inflation at e same time! Land is always your best buy. . ." (CX 43) Other statements contributing to the general investment eme include those referring to the land as "investment property" (CX 58), suggesting that the land be purchased d held "for the future" (CX 67), and warning that the quantity of land was declining so that this purchase was ne opportunity of a lifetime." (CXs 46, 71)

[22] Respondents used four different color brochures. (CXs 86-89) The first (CX 86)—a SWS brochure—was epared and used by Southwest Land Corp., a former marketer of the land. When respondents bought the land 1973 they continued to use the same brochure for some 60 to 90 days while a new one was in preparation. The cond brochure (CX 87)—also a SWS brochure—was a revision of the first one that eliminated a few explicit vestment and land appreciation claims. The third and fourth brochures (CXs 88, 89) were revised for use with es of GVA and GVA II property, and a few additional investment-oriented references were deleted. The ochures used early in marketing efforts at SWS were the most explicit, calling the land at SWS the "new prime vestment spot in the Southwest," describing "leaping" land values, and projecting even greater "future growth tential." (CX 86I) Similarly, references to residential and commercial uses of the land in the SWS brochures companied the observation that this land offered purchasers many possibilities "as an investor." (CXs 86I, 87J)

[23] According to Kritzler, the second SWS brochure was "toned down" from the earlier one because "we were t selling appreciation of the land. We were selling use." (Kritzler Tr. 4103) However, only some references to vestment were deleted while others were retained. Kritzler also testified that the subsequent brochures prepared GVA and GVA II were not as direct as the first SWS brochure because respondents believed that various state d federal regulatory agencies discouraged investment representations. (Kritzler Tr. 4105) Again, some invest- nt representations were eliminated and others retained.

[24] The brochures contained the following quotations:

> Theodore Roosevelt: "Every person who invests in well-selected real estate in a growing section of a prosperous community adopts the surest and safest method of becoming independent, for real estate is the basis of wealth."
>
> Grover Cleveland: "No investment on earth is so safe, so sure, so certain to enrich its owners as undeveloped realty. I always advise my friends to place their savings in realty near some growing city. There is no such savings bank anywhere."
>
> Andrew Carnegie: "Ninety percent of all millionaires become so through owning real estate. More money has been made in real estate than in all industrial investments combined. The wise young man or wage earner of today invests his money in real estate."

(footnote cont'd)

The sales presentations used by respondents and their brokers elaborated on the investment value theme, as numerous witnesses testified. Indeed, sales representatives for respondents and for their brokers were authorized to repeat this theme in oral sales pitches because respondents supplied sales representatives with brochures raising the investment idea for use in their marketing efforts. (Hammer Tr. 652, 657; Kritzler Tr. 4107; Porter Tr. 2271-72) We conclude that these oral and written statements about the value of land as an

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Marshall Field: "Buying real estate is not only the best way, the quickest way, and the safest way, but the only way to become wealthy."

George Washington: "A moment's reflection must convince you of two things: first, that lands are of permanent value; that there is scarcely a possibility of their falling in price, but almost a moral certainty of their rising exceedingly in value."

(CXs 86 to 88) The GVA II brochure (CX 89) contained all but the quotation from Washington.

[25] Other written materials respondents used had a similar approach and effect. For example, newspaper and magazine articles on farming and commercial developments in the area which were provided to actual and prospective purchasers consistently stressed the point that land is valuable, its price is soaring as its availability declines, and it is the best money-making investment. (CXs 91, 106, 109, 111, 131) Though most of these articles did not describe SWS, GVA, and GVA II property, their use by respondents makes a connection to respondents' land unavoidable. The same is true of respondents' picture book used by sales staff in Houston and Dallas (CX 170), which emphasized the growth potential and value of land and set forth "A Reluctant Investor's Lament," a poem describing numerous good land investments (including Peter Minuit's purchase of Manhattan for a few "trinkets") missed by the narrator who hesitated to buy at the right time or price. These materials do not of themselves refer to respondents' land but they appear interspersed with photos of land in the Van Horn area and articles about respondents' property and developments in West Texas, thus providing a specific link to respondents' land. *See AMREP Corp., supra.* We find all of these general commentaries contributed to the investment theme respondents' presented to consumers. Whether such representations, standing alone, represent that respondents' property is a good, low-risk investment we need not and do not find. We conclude instead that they supplemented and therefore contributed to the investment value representations made throughout respondents' sales materials and sales presentations.

investment represented to consumers that respondents' land, too, was a good investment and was being sold for investment purposes (*i.e.*, as a safe way to make money).

2. Profit, Resale and Safety Representations

After establishing with consumers the representation that their land, like all land, was generally a good, safe investment, respondents elaborated on the point by describing in more concrete terms how valuable the investment was. The SWS brochures stressed that the value of property in the region was "leaping every year" and had "unlimited" growth potential. (CXs **[28]** 86I, 87J) Respondents' first SWS brochure, used for two to three months, added the express claim that land in the area had "increased in value by over 20%" in the previous year. (CX 86I)

Similar assertions were made in oral sales presentations to prospects. Many consumers were told that their land would appreciate and could be resold for a profit in a short time frame, from three to four months to a few years.[26] Others were told they would double or triple their investment or make "lots of money."[27] Sales representatives offered assurances on numerous occasions that the land could be resold quickly and for a substantial profit. They also emphasized the safe and risk-free nature of the purchase, suggesting that there would be no **[29]** loss on the resale nor any delay in receipt of its proceeds.[28] The testimony of consumer witnesses in the record further confirms that they understood respondents' statements to be investment representations; numerous purchasers gave as reasons for their purchases that they bought the land for resale, to make a profit, and to hold as a short-term investment. (Baldridge Tr. 821; Switaj Tr. 1288; Morley Tr. 1347; Limpp Tr. 1400; Grygleski Tr. 1453; Allienello Tr. 1641; Davis Tr. 1680–81; Lambert Tr. 1787, Leuckel Tr. 1829; Robinson Tr.

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[26] Many witnesses testified that they or family members were told expressly by sales personnel for respondents or their brokers that they could make substantial profits for various reasons by buying the land and holding it for only a few years. (Switaj Tr. 1276, 1279–80, 1287; Morley Tr. 1340–42; Limpp Tr. 1399–1400, 1402; Grygleski Tr. 1446, 1453, 1456, 1474; Buck Tr. 1503; Allienello Tr. 1624, 1626–27; Goldstein Tr. 1719–22; Lambert Tr. 1284–88, 1297; Leuckel Tr. 1823–25, 1827, 1829, 1831–32, 1834, 1868–69; Robinson Tr. 1914; Sweets Tr. 1948–53; Smith Tr. 2064–65, 2070) The time period in which appreciation was promised ranged from three or four months (Leuckel Tr. 1824, 1862) to two or three years. (Switaj Tr. 1341) Several consumers were promised profits in one or two years. (Sweets Tr. 1948; Smith Tr. 2064; Danskin Tr. 2422)

[27] Several consumers were told that the land would double or triple in value and then could be resold. (Bear Tr. 1117; Buck Tr. 1503; Stein Tr. 2204; Munch Tr. 2524) Many were told that the land was appreciating, had great "resale potential" or could be turned over quickly. (Switaj Tr. 1287, Lambert Tr. 1784; Rawlins Tr. 2150; Swanson Tr. 2463, 2469) One consumer expressed reservations to the Porter Realty sales representative, commenting "you will make me a rich man or a poor man." The sales representative replied, "I will make you lots of money." (Switaj Tr. 1280)

[28] Some purchasers were assured they would suffer no loss on their purchases since they would always be able to get back the money they put in. (Robinson Tr. 1915; Munch Tr. 2451) Indeed, Mr. Porter expressed surprise to one consumer that respondents had not yet tried to buy back his parcel because it was such a good deal. (Sweets Tr. 1959) Respondent Gross confirmed the message behind the representation that respondents' land "can be a hedge against inflation" (CX 43) when he testified that his basis for the statement was that it "certainly isn't going to go down in value." (Gross Tr. 414)

1915; Smith Tr. 2062; Schlacter Tr. 2114; Sowell Tr. 2516; Munch Tr. 2557)

As evidence either that the representations were not made or were not misleading, the ALJ relied on the fact that consumers discounted these representations by testifying that they knew there was no guarantee they would profit. (ID p. 113) In our view, this misapprehends both the allegation of the complaint and the substance of this testimony (most of which was elicited on cross-examination). Count I alleges not that profits were guaranteed but that the land was marketed as a good investment with little or no risk. Consumers' understanding that the land was not "guaranteed" or that investments generally were not risk-**[30]**free simply does not resolve the issue of whether respondents marketed the land as having little or no risk. An admission that consumers recognized these investments as having some risk is not inconsistent with the complaint allegation that respondents represented their land as having *little* risk. Moreover, consumers could have general knowledge of the riskiness of investments and still believe that *this* investment differed from the run-of-the-mill. Indeed, respondents' marketing program seems designed to distinguish these investments from those the witnesses believed had some risk by suggesting the land was a safe and sure way to profit. We believe the ALJ erred to the extent he suggested that consumers' unfocused, common sense beliefs about risks in investing eliminated the propensity of respondents' representations to lead consumers to believe this land was a good investment.

3. Representations About Development and Use of the Land

Perhaps the most common and pervasive investment representations respondents conveyed about their land were representations that it was a good investment because it could be developed and used for assorted purposes. The specific possibilities raised included oil and gas production, other commercial and industrial development, and residential, farming and ranching applications.

The most controversial development representation relates to the potential for oil and gas production on respondents' land. The record demonstrates that these representations were made primarily in connection with sales of land at GVA and GVA II. **[31]** Respondents' written materials contributed to oil and gas representations by referring to oil as one of several major industries in the area (CXs 83–85 (GVA and GVA II fact sheets)) and by pointing out that "oil production is underway" in the county.[29] (CXs 88F, 89D (GVA and GVA II brochures)) More explicit representations came from the "oil map" used by respondents' brokers, which demonstrated the presence of oil in the area graphically by indicating the location of oil and gas wells in one part of Culberson County and by listing the names of oil companies with land holdings near GVA and GVA II. (CX 129) As one salesman noted, with the oil map there was little additional need to tell buyers about oil in the area because they could see on the map that Texaco owned land or mineral rights and buyers would ask about it even when oil was not mentioned to them. (W.D. Smith Tr. 973)

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[29] We cannot agree with respondents' assessment of these references as "innocuous." Not only was oil cited as a major industry in the area and thus as a rationale for the land's purchase, but references in respondents' written materials to the oil industry and oil production elsewhere in the county served as a basis for oral representations to the same effect which respondents authorized its brokers and sales representatives to make.

Whether or not the oil map made it unnecessary to mention oil, many sales representatives did mention it. Sales representatives for the brokers referred repeatedly to oil development in telephone conversations with consumers, informing them that exploration was underway in the area and that oil companies were moving into the area and might be interested in **[32]** buying their land.[30] Some representatives went on to describe how increasing oil exploration in the area would lead to construction of an oil refinery and in turn to a demand for land for worker housing, so that consumers were assured of making money whether or not oil and gas was discovered on their property. (Allienello Tr. 1624, 1651; Morley Tr. 1350; Danskin Tr. 2429)

The record does not reveal a pattern of express representations that oil actually existed or was sure to be discovered under the land respondents were marketing.[31] Rather, the record shows a concerted effort by respondents as well as by their brokers to highlight for consumers the oil industry in the area and to emphasize the fact that oil exploration was occurring **[33]** nearby while creating the impression (particularly through the "oil map") that there were substantial oil reserves quite near the property. As we discuss *infra*, under the legal analysis described in Section III, these practices represented to consumers that respondents' land had substantial value as an investment because of the presence of oil and oil-related development.[32]

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[30] A number of consumers were told that oil companies had done "a lot of exploration" or were moving into the area. (Sweets Tr. 1959; Grygleski Tr. 1456–57; Swanson Tr. 2468) Other consumers were assured that there was "great potential" for oil discovery or that oil was "nearby" or "in the vicinity." (Goldstein Tr. 1720–21; Munch Tr. 2524, 2567; E. Smith Tr. 2073–74; Grygleski Tr. 1455; Limpp Tr. 1422; Rawlins Tr. 2149) Some sales representatives explained that the possibility of oil made respondents' land an attractive investment because "oil companies wanted to lease or buy the land to eventually look for oil on it" (Stein Tr. 2202) and because landowners could sell oil and gas found on the property directly to the company that made the discovery or make a royalty arrangement. (Goldstein Tr. 1721)

That Porter Realty's sales representatives discussed oil development in the area with prospective purchasers is confirmed by the fact that the company's script for first telephone calls refers to oil as a major industry in the region. (CXs 122, 123) According to respondent Kritzler, oil-related representations by Porter Realty may have affected 60 percent of the firm's sales. (Kritzler Tr. 598)

[31] One consumer was told oil was there or would be found as soon as drilling commenced. (Limpp Tr. 1389)

[32] Testimony from a number of consumer witnesses confirms they believed the land they purchased had value because of the likelihood of oil exploration and related development activities. (Limpp Tr. 1395; Grygleski Tr. 1492; Sweets Tr. 1959; Rawlins Tr. 2181; Stein Tr. 2221, Swanson Tr. 2471–72) Indeed, Richard Morley maintained that he would not have purchased the land had he not been assured that Texaco would buy it from him for a refinery. (Morley Tr. 1384)

Respondents also promoted their land as an investment by describing various potential commercial and industrial developments in the area. Several consumers were told there might be a nuclear power plant or uranium enrichment plant constructed in the area and that the property therefore would increase in value. (*See* Goldstein Tr. 1726; Lambert Tr. 1789; Sweets Tr. 1950, 1959; Danskin Tr. 2429–30; Munch Tr. 2526, 2565) Respondents included news articles about a possible new power plant in their promotional picture book and in mailings to purchasers. (CXs 93, 170P) Respondents' references to possible construction of a rubber plant for processing guayule (which purportedly could be grown on the land) conveyed a similar message. (Leuckel Tr. 1823–24; Gross Tr. 568–73; *see* CXs 119, 120)

Respondents also emphasized the current and future value of their land by pointing to its potential use as residential, farming and ranching property. Indeed, respondents admit **[34]** representations were made about use of the land for these three purposes (RAB 36, 39, 45–46), though there is some dispute about how broadly those representations were made. However, we find that respondents' representations about the practical uses of the land contributed to the impression that purchase of the land was a good investment because these uses could attract other purchasers who might buy the land for those purposes.

4. Respondents' Oral Representations

The ALJ concluded that some oral investment representations were made by respondents' brokers but that a pattern of such claims could not be attributed to respondents' own sales force. (ID 82) We find sufficient evidence that such representations were in fact made by respondents' own sales representatives. As we have noted above, many of respondents' promotional materials contained express and implied investment representations, including allusions to the fast appreciation of the land and its proximity to oil exploration. Respondnets' sales representatives were authorized to rely on these materials in their sales pitches. Moreover, several consumer witnesses testified about investment claims made not by the brokers but by respondents or their sales personnel. (Leuckel Tr. 1824, 1843, 1862; Buck Tr. 1503, Robinson Tr. 1919, Danskin Tr. 2432; Davis Tr. 1694–98) Although the bulk of the oral representations in the record (particularly those pertaining to oil activities) were made by Porter Realty and Diversified Realty, we believe that respondents' written and oral practices included a pattern of investment-related representations. **[35]**

B. *Accuracy and Completeness of Respondents' Investment Representations*

Having determined that investment representations were made to consumers, we next must determine whether respondents may have misled consumers either because their representations were inaccurate or because they failed to reveal material facts needed to correct misimpressions their actions created. The essential question is, was the land at the prices at which it was sold a profitable, safe, and easily resold investment with little or no risk of loss? The record demonstrates that it was not, and that respondents' practices were misleading both because the representations were inaccurate and because they failed to disclose to consumers the uncertainty of the land's future value and the absence of a resale market.

1. Accuracy of Investment Representations

Our focus in evaluating respondents' investment claims must be on the available evidence of the land's value, appreciation, profitability, resale potential, and safety during the time in which it was sold, and how closely evidence as to these points corresponded to respondents' affirmative representations of the land's investment value and freedom from risk. Testimony about the land's market value during the relevant time period provides some evidence of its value and its potential for appreciation and profit. Witnesses for both parties testified as to the land's market value. (ID 379–429) Estimates varied from below $100 an acre to over $500 an acre depending on the time period and parcel size. (ID 400, 429) The following chart summarizes some of the relevant testimony as to the land's estimated market value and **[36]** selling price per acre provided by complaint counsel's primary witness E.T. Compere, Jr., respondents' primary witness Larry Brooks, and respondent Kritzler.

	SWS (1/74)	**GVA (1/76)**	**GVA II (1/77)**	**SWS (7/80)**	**GVA (7/80)**	**GVA II (7/80)**
Estimated market value per acre of land sold in large tracts (Compere Tr. 3226–30, 3275)	$35	$50	$60	$60	$65	$80

	SWS (1/74)	GVA (1/76)	GVA II (1/77)	SWS (7/80)	GVA (7/80)	GVA II (7/80)
Estimated market value per acre of land sold in parcels of five to 40 acres (Compere Tr. 3226–30, 3275)	$54–62	$55–62	$90–110	$90–110	$70–95	$70–110
Estimated market value per acre of land sold in tracts of:						
five acres				$525	$525	$525
ten acres				$475	$475	$475
20 acres				$375	$375	$375
40 acres				$275	$275	$275
(Brooks Tr. 4411)						
Selling prices per acre for land sold in five acre tracts (Kritzler Tr. 487–93)	$600	$800–1200	$1,000	$700	$800–1200	$1100-1200

Respondents' sales prices—ranging from $600 per acre in SWS in 1974 to $1200 per acre in GVA II in 1980—thus far exceeded the market value estimated by expert witnesses for both parties. In [37] complaint counsel's view, these prices were approximately ten times the market value of the land, while in the view of respondents' experts these prices were at least 50 percent more than and perhaps double the market value of the land.

These figures allow us to consider whether in fact purchasers of the land could have realized profits during the period for which data are available, assuming the land could be resold for its market value. According to respondents' expert, a consumer who purchased five acres at SWS for $600 an acre in 1974 owned property worth only $525 an acre six years later in 1980. Similarly, a consumer who bought a five acre parcel at GVA II for $1,000 an acre in 1977 owned property worth only $525 an acre three years later in 1980. Even assuming sales at above market value (Compere Tr. 3454) and appreciation of the property[33] consumers were unlikely to break even on their resales, if the land could in fact be resold.

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[33] Brooks testified that land in the area was appreciating at the rate of one-half of one percent per month, or six percent a year. (ID 425) This testimony contrasts with respondents' claims that land in the region had appreciated 20 percent one year and was "leaping" every year. (CXs 86I, 87J)

These discrepancies between the land's estimated value and the prices consumers paid may explain in large measure the next significant fact established in the record: that there was virtually no resale market for the land. Reselling the land without the assistance of respondents or their brokers was at best a rare event. Some resales were handled by Porter Realty, but these were exceptions to the general refusal of respondents **[38]** to resell buyers' properties.[34] In any event resales by Porter Realty do not provide much insight into the value or liquidity of the land since such resales were accompanied by the same sorts of representations that accomplished the original sales. (Stein Tr. 2198–2228; Rawlins Tr. 2146–97)

More probative on these issues is the testimony of Martha Conoly, the only full-time real estate broker in the Van Horn area.[35] She stated that she was contacted by purchasers of the property who sought to list their land for resale, but she refused to take any such listings because of the lack of demand. More specifically, Mrs. Conoly maintained that there was little demand for land in the Van Horn area unless utilities were available and present on the property. Respondents' land was sold as undeveloped property without water or utilities installed. She also testified that no other realtors in the county had accepted listings on the property. (Conoly Tr. 1063–68) **[39]**

Numerous buyers testified likewise that they tried but were unable to list the land for sale with a realtor. (Bear Tr. 1128; Switaj Tr. 1313; Goldstein Tr. 1743; Sowell Tr. 2519) Indeed, respondents conceded that at least half of complaint counsel's witnesses were unable to resell their lots.[36] Mr. Lambert's efforts to resell his property are enlightening. He purchased 10 acres of GVA land for $4,995 and later listed the property for sale with an independent realty company in Houston after respondents' salesman refused to try to resell it. (Lambert Tr. 1794–95; CXs 369, 446–447) He listed the property with an asking price of $8,000, after one of respondents' sales representatives told him his land was worth that amount. After two years on the market and a reduction in his asking price to either $4,000 or $5,000, Lambert had not sold the land and had received no serious contacts. (Lambert Tr. 1793–96)

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[34] At least two consumers sold their land to third persons through Porter Realty, and perhaps more were successful. (ID 99, 101; RAB 52-53)

[35] Mrs. Conoly also testified as to her assessment of the market value of the land in its undeveloped state, pegging it at $50 to $70 per acre. The ALJ gave little weight to this testimony. Respondents attack her testimony with the curious argument that she was not qualified to estimate the land's value though she was qualified to say at what price she could sell it. They also criticize the knowledge and basis she had for her valuations. (RAB 51) We believe Mrs. Conoly's experience and credentials are such that her estimates of the land's value deserve more than minimal weight, and we consider her testimony probative on the issue of the land's market value.

[36] Respondents assert there is evidence that 76 parcels were successfully resold while only eleven consumers were unsuccessful. (RAB 52) As support, respondents cite six sales (including three by a single owner and two by Porter Realty) and an "admission" of complaint counsel that 70 other resales were made by 62 owners. (RAB 52–53) Whether or not the Commission may properly consider this admission (now disputed by complaint counsel) probative evidence, we decline to give it much weight since there is no other evidence of this level of resales in the record, no explanation that we can discern for the absence of such confirming evidence, and the credibility of complaint counsel's supposed admission seems at best questionable.

Respondents' efforts to distinguish between the value of their land and its liquidity are in our view unavailing. (RAB 22, 53 n.42) First, the record establishes that respondents represented one aspect of the land's investment value to be its **[40]** ease of resale. To the extent respondents concede the property is not liquid and cannot easily or quickly be resold (as the record confirms), these representations are admitted to be false. Moreover, the definition of fair market value set forth by witnesses for both parties includes consideration of whether sale of the property can be completed within a reasonable time frame. (Compere Tr. 3182; Brooks Tr. 4324–25) It follows that the length of time required to sell a property—its liquidity, in other words—has a decided bearing on its value.

Our review of the record evidence leads us to conclude that respondents' investment representations—that the land was a good investment, could be resold easily and quickly, for a profit, and with little or no risk—were not accurate. Regardless of which assessment of market value we accept, the selling prices substantially exceeded fair market value so that profits—and certainly profits of the level respondents and their brokers declared possible—were unlikely to be attained.[37] Nor does it appear that the property appreciated rapidly so that short-term profits could be taken; the testimony **[41]** of respondents' own expert is to the contrary. (ID 425) Extensive evidence as to the absence of a resale market also contradicts respondents' assertions that the land could be turned over quickly and was a safe investment since consumers who wanted to get back their monetary investment had difficulty doing so even when the land was on the market for extended periods or at reduced prices. The absence of any resale market demonstrates in this instance the low value of the land relative to its selling price, the resulting inability of owners to realize profits because sales cannot be accomplished, and the difficulty owners have getting their monetary investment back without a substantial loss, all contrary to respondents' marketing messages. In the context of this evidence, we find that respondents' investment representations were inaccurate and therefore misleading. *See AMREP Corp.*, 102 F.T.C. 1362, 1637–42 (1983), *petition for review filed*, No. 84–1434 (10th Cir., April 2, 1984); *Horizon Corp.*, 97 F.T.C. 464, 817–20 (1981).

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[37] We do not suggest here that land must be sold at or near its fair market value to pass muster under Section 5 of the FTC Act, and we need not and do not reach any conclusions about what the "correct" selling price of the land should be. (Indeed we would be extremely hesitant to second-guess the market in making such a determination.) We also do not suggest that the sale of property at prices two to ten times its market value is, in and of itself, misleading or deceptive. It is instead the sale of property at such prices in combination with representations that it is a good, profitable, low-risk investment that establishes liability in this case because of the effect elevated prices have on the potential appreciation and profitability of consumers' investments.

2. Accuracy of Development Representations

Respondents' principal development representations involved references to oil and gas activity and to other commercial developments including a potential nuclear plant. With respect to the claims about oil and gas, the ALJ determined that "much of what was represented to prospective purchasers concerning oil turned out to be at least reasonably accurate." (ID p. 113) However, he did not discuss this conclusion at length because he **[42]** found that Porter Realty was responsible for most of the representations and that respondents were not liable for their brokers' conduct.

The record establishes that at least some of respondents' oil and gas representations were literally true. Oil drilling clearly is an industry in Culberson County, as respondents claimed. There is some petroleum production in the northeast corner of the county, and exploration efforts are underway there as well. (Watkins Tr. 2723; Case Tr. 4524) However, most of the oil production in the county is at least 40 miles from SWS and 60 miles from GVA and GVA II.[38] (Watkins Tr. 2733–35) Texaco has drilled only one well within 25 miles of Van Horn,[39] there is no petroleum production in the county apart from the activity in the northeast corner, and there is no production in neighboring counties. (Watkins 2724)

It is also true, as respondents' brokers represented, that some oil companies have moved into the Van Horn area and obtained leases on nearby land. Texaco, for example, purchased some leases on land in another county within five miles of GVA, but this occurred since April 1979, well after most oil-related claims were disseminated. (Watkins Tr. 2746) But the land so **[43]** leased has not been used for exploration. (Watkins Tr. 2755) Some exploration has occurred on or near the subject properties, but the exploration, mostly "seismic" or "geophysical," which does not involve drilling, has also been recent, since 1979 or 1980. (Case Tr. 4534) Most significantly, Lyle Case, a Texaco official, described the area in which respondents' properties are located as "frontier," meaning that they are not known to have commercial amounts of oil and gas, though there is a possibility. (Case Tr. 4533)

The literal truth of some of respondents' oil-related claims is, however, simply not determinative.[40] Instead, we must determine whether the existence of oil activity in Culberson County to which respondents referred had significance for respondents' land and, as their statements implied, increased its investment value.

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[38] Significantly, the oil map sent to numerous consumers did not disclose the distances between the GVA and GVA II properties shown on the first page and the oil company holdings on page three. Another geographical map in evidence (CX 160(O)) indicates that these areas are separated by at least 60 miles.

[39] Texaco's employee testified that the nearest well to respondents' land the company had drilled was a dry hole. (Case Tr. 4535–36)

[40] The law has long recognized that literally true statements may nevertheless convey misleading impressions. *See Rhodes Pharmacal Co. v. FTC*, 208 F.2 382, 387 (7th Cir. 1953), *rev'd to reinstate Commission's order*, 348 U.S. 940 (1955); *P. Lorillard Co. v. FTC*, 186 F.2d 52, 58 (4th Cir. 1950); *Raymond Lee Organization, Inc.*, 92 F.T.C. 489, 626 (1978), *aff'd*, 679 F.2d 905 (D.C. Cir. 1980). For example, in advertisements for respondents' products, state-

(footnote cont'd)

The record evidence establishes that oil drilling and production were not taking place close to the land respondents [44] sold. The physical distance between oil companies' production activities and the subject properties suggests that these activities have little bearing on the likelihood that oil might be discovered near GVA and GVA II, and therefore do not influence the land's value. This is confirmed by the testimony of Texaco's official that respondents' land is "frontier," which means there was a substantial risk that oil would *not* be found on or near the land. Similarly, the record demonstrates that oil company exploration and leasing activities near the GVA and GVA II sites were neither extensive nor successful in locating oil reserves. These facts belie respondents' assertion as to the record's failure to show that nearby oil activity has not increased this land's value. (RAB 19) In the context of this evidence, we find that the repeated references to oil production in the county by respondents and their brokers distorted its proximity and exaggerated its significance so that the representations were inaccurate and therefore misleading. *See P. Lorillard Co. v. FTC*, 186 F.2d 52, 58 (4th Cir. 1950).

Representations by respondents' brokers were often more pointed than simple statements about the existence of drilling and exploration work nearby. Sales representatives on many occasions stated overtly not only that there was oil activity in the region but also that this made respondents' land more valuable and a good investment with little or no risk. The record evidence contradicts these claims. The investment value of respondents' land could only be enhanced if oil were likely to be found on the property or nearby. Yet the testimony of a [45] Texaco official established that this is an exceedingly remote possibility. The likelihood that the land would be purchased and used for workers' housing as some sales representatives asserted is equally slim. Exploration and production efforts were neither close nor extensive enough to warrant purchase of the land for these purposes. Representing that local oil-related activities made respondents' land a valuable low-risk investment was therefore inaccurate and misleading. *See AMREP Corp.*, 102 F.T.C. 1362, 1640–41 (1983), *petition for review filed*, No. 84–1434 (10th Cir., April 2, 1984).

Respondents also represented orally and in writing that their land

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ments about other, similar products may mislead consumers as half-truths or as deceptive implied representations that the statements apply equally to all products, including respondents'. It is thus irrelevant to argue, as respondents appear to do (RAB 19), that complaint counsel here failed to carry their burden of showing the falsity of statements about land *other than* respondents' on which oil exploration may be occurring. Respondents used those statements to represent inaccurately that *respondents'* land had substantial investment value because of the presence of oil and oil-related development.

was a good investment because of other potential or likely commercial developments in the area,[41] including the proposed construction of a nuclear power plant. For example, respondents reproduced for consumers excerpts of news articles describing how a group of electric utilities had purchased land and water rights near SWS for possible construction of a power **[46]** plant and stating that then-President Ford proposed that private uranium fuel plants be publicly financed. (CX 93) However, respondent Kritzler admitted that the group that purchased the site "never said that they have a direct proposal to build the power plant," and he conceded that they "had no date in mind as yet." (Kritzler Tr. 560) The absence of a concrete plan or timetable for construction of a power plant made it highly unlikely that purchasers' land values would increase as a result of this development, or that the development itself would ever take place.

Similarly, respondents' allusions to other commercial and industrial developments, including construction of a processing plant to make guayule rubber, provided an exaggerated sense of the land's value. Though respondents repeatedly emphasized Congress' authorization of $30 million to develop a guayule industry, they failed to mention that no money was ever appropriated for this purpose. (ID 360) Moreover, complaint counsel's expert witness, Daniel Bragg, painted an extremely negative picture of the likely development of a commercial guayule industry resulting both from the difficulty and expense of raising the guayule plant and from the lack of demand for guayule rubber. (ID 361–68) He also noted that no guayule processing or extraction plants currently exist. (ID 366) This evidence leads us to conclude it is highly improbable that the potential for development of a guayule industry in southwest Texas enhanced the value of respondents' property. Accordingly, we find respondents' representations that commercial **[47]** developments, including construction of a nuclear plant or establishment of a guayule industry in the area, render their property a more valuable investment to be inaccurate and exaggerated and therefore misleading.

3. Disclosures

Neither respondents nor their brokers disclosed the substantial risks associated with investing in their land. Nor did they reveal the difficulty consumers might have reselling their interests in the land or recouping their original monetary investments. Indeed, respondents' stated position was that they were selling use, not investment (Kritzler Tr. 4103), so that warnings about the riskiness of the land as an investment were not, in their view, warranted.[42]

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[41] Respondents argue that they neither distorted nor wrote the news articles about local commercial developments and that they were true. However, as we noted above, true claims, including statements accurately drawn from newspaper accounts, may nevertheless convey misleading impressions to consumers. *See P. Lorillard Co. v. FTC*, 186 F.2d 52, 58 (4th Cir. 1950). Respondents used these materials moreover not simply to inform consumers as to possible developments of general interest, but to encourage them to continue their payments on existing land or to consider additional purchases. In this context, respondents' intended message was clearly that the developments reported in various news accounts enhanced the value of respondents' land and made its purchase worthwhile. As to respondents' asserted lack of involvement in writing the articles describing local commercial developments, we note there is some evidence that respondents actually paid for one Chamber of Commerce brochure they used in marketing. (CX 219; Mitchell Tr. 3745)

Respondents implicitly acknowledge that sales representatives made investment representations to prospective purchasers without disclosing the riskiness of the investment. This is evident from respondents' practice of recontacting after purchase some customers to whom investment representations had been made in order to inform them "we cannot tell you there would be any profitability in the purchase of this land." (Kritzler Tr. 597) Such disclosures, had they been made prior to purchase, **[48]** might have cured what otherwise were significant omissions of information about the land consumers contemplated buying.[43] The record makes clear instead that respondents' oral and written investment representations portrayed the land as a profitable and safe investment yet failed to inform consumers before they purchased of the riskiness of the land as an investment. Because consumers had contrary beliefs about their purchases—created by respondents' own actions—we conclude that respondents' failure to disclose these facts was misleading.

C. *Land Use Representations*

Count II of the complaint (paragraphs twelve through fourteen) charged respondents with promoting their land as suitable for use by purchasers as homesites, farms and ranches when in fact it was not suitable for such uses and respondents did not disclose facts bearing on its suitability. The principal land use representations made in respondents' promotional literature and in oral discussions with prospects concerned use of the land for residential, farming, ranching and other agricultural purposes. The fact that the land was promoted for these uses is not in dispute, but the exact meaning or import of the promotional claims is. **[49]**

1. Use as Homesites

Respondents admittedly represented to potential buyers that parcels they sold could be used as homesites. (ID 135, RAB 39, 45–46) Such

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[42] Respondents also argue that they had no responsibility "to disclose facts which are already known to purchasers." (RAB 22-23, *citing FTC v. Simeon Management Corp.*, 532 F.2d 708, 716 (9th Cir. 1976)). While this may ordinarily be true, it does not follow that respondents had no obligation here to inform consumers about the uncertainty and risk associated with the purchase of their land since we have previously found that, in the absence of disclosures, respondents' marketing program represented that their land was a good, low-risk investment. *See* Section II.A.2., *supra*.

[43] Whether presale disclosures would indeed have cured this deception we need not determine, since we find that adequate disclosures were not in fact made. However, we note that the timing and format used to effect disclosures may be such that they do not successfully remove the deception. *See Peacock Buick, Inc.*, 86 F.T.C. 1532, 1562–63 (1975), *aff'd*, 553 F.2d 97 (4th Cir. 1977) (opinion unpublished).

›resentations were made repeatedly in the printed materials pre-
red by respondents and given to potential purchasers. For example,
the SWS brochures, potential buyers were told they could use the
ıd as a "country estate": "Today more and more families are de-
uncing the hectic pace, the polluted atmosphere and overcrowded
nditions of the cities in favor of a quieter, more peaceful, relaxed
d meaningful existence. Your five acres of land could be a haven
· you and your children." (CXs 86I, 87J) The "artists' conception"
the "estate" depicts a substantial house with a swimming pool,
nnis court, fenced horse pen, and stables. (*See also* CX 88J (describ-
g "country estate" in GVA and GVA II brochures)) We conclude
spondents expressly represented that their land was suitable for
mesites and in particular was suitable for elaborate residential
es.

2. Farming Uses

Respondents made several references in their promotions to pur-
asers' ability to farm, garden, and raise produce on the properties.
›mplaint counsel argue that the properties were represented as
armland" suitable for "productive farming," when they were not
itable for that use because of high costs. (CCAB 27–30) Respondents
unter that consumers were not told that **[50]** they could operate a
ommercial" farm on five acres, but that they could "earn modest
nounts of money by selling some of their produce." (RAB 39)

The record indicates that consumers were told they could grow
getables and other crops for their own consumption as well as for
le to others. Indeed, numerous references in respondents' advertise-
ents and promotional brochures described the land as suitable for
rming or orchards and not simply for personal gardening or small-
ale growing.[44] (CXs 53, 54, 56, 57, 66, 69, 71, 86, 87, 88, 89) This point
as reinforced when respondents referred to farming as a major in-
ıstry in the area, informed prospects of commercial farming opera-
›ns underway nearby, and noted the existence of a "railhead"
·arby, presumably for those who wished to ship produce to market.
Xs 83–85, 86–89, 90, 92, 100)

Respondents' promotional statements also suggested that use of the
nd for farming would be profitable as enough produce could be
ised to supply a purchaser's own needs and sell to others. The profit
presented was not merely extra pocket money, but enough to make
nsumers self-sufficient. For example, many of respondents' adver-
sements raised the possibility of owner self-sufficiency on five-acre
ırcels through such phrases as "become financially independent on

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[4] While most advertisements focused on the farming potential of the land, one series featuring actor James
ıry spoke not of farming but of gardening. (CXs 61B, 64)

your own five-acre farmette" and "buy independence and protect [51] yourself against inflation at the same time!" (CXs 42, 43) Similarly, an advertisement stressed that the land would grow produce "for your *own* table as well as for sale to others." (CX 58; *see also* CXs 59, 60) And a newspaper article sent to prospective and actual purchasers of the land envisioned the area "producing tremendous food supplies for the nation" and spoke of small plot owners making a "doggone good living producing vegetables, fruit, or whatever." (CX 91)

Because the references to farming always related to the small parcels respondents sold, we do not believe respondents represented that large-scale commercial farming operations of the sort requiring extensive acreage could be conducted on the individual parcels. Instead, respondents' assertions expressly represent that sufficient produce could be grown to meet personal needs and to sell for at least subsistence level living. In addition, under the legal analysis described in Section III, *infra*, we conclude that, in conjunction with the various investment representations described above, respondents' farming representations implied that potential uses of the land for farming-related activities made it a good investment.

3. Ranching Uses

A variety of respondents' marketing materials stated the land could be used for raising cattle. Complaint counsel assert that this meant the land "could be used to ranch, which involves raising more than one or two cows." (CCAB 33) Respondents [52] counter with the ALJ's conclusion that "what respondents are saying is that it is possible to raise enough beef on the land to feed one's self or one's family." (ID 156; RAB 45–46)

We cannot accept complaint counsel's assertion that respondents claimed more than one or two cows could be raised on a five-acre parcel. Respondents admit that they made representations about raising cattle for home consumption. (RAB 45–46) Typical of their representations is a television advertisement which stated that consumers could "raise beef on . . . [the land] and have enough of everything for your own table." (CX 51; *see also* CX 50 ("raise livestock and put beefsteak back in your food budget")) While it is true that respondents also called the land "ranch land" in advertisements and materials (ID 156), the context of these statements does not suggest respondents were recommending that purchasers could use the land for commercial ranching purposes.[45] We conclude that respondents expressly represented that one or two head of cattle for personal consumption could be raised on the land by grazing or ranching. We also conclude under the legal analysis described [53] in Section III, *infra*, that respondents' references to ranching, made in conjunction with claims that the land was a good investment, impliedly represented that the land's potential usefulness for raising cattle made it a good investment for consumers.

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[45] This land was "ranch land," used to raise cattle commercially, some time before respondents bought it. (ID 14, 21) However, it appears unlikely that it will ever be used for commercial ranching in the future because of the problem of fractionalization that we noted in *Horizon Corp.*, 97 F.T.C. 464, 819 (1981). Once this land is divided into thousands of small parcels it is unlikely ever again to be combined into the single large parcel that might be attractive to a commercial rancher. (Conoly Tr. 1060) Commercial ranching requires a minimum 10,000 acre parcel

(footnote cont'd)

D. *Accuracy and Completeness of Land Use Representations*

The complaint charged in Count II that respondents' representations about the uses for which the land was suited were misleading because of the unavailability and high cost of obtaining utilities, water, and other amenities, because of respondents' failure to install promised improvements, and because of other practices by respondents that impaired purchasers' use of their land. We consider these charges from two perspectives. First, respondents' representations about the land's suitability for residential, farming and ranching uses may be misleading because the land is not suitable for those purposes on a practical, economic basis. Second, respondents may have misled consumers by failing to disclose material information concerning the high costs and risks associated with using the parcels as they represented.

Whether respondents inaccurately represented that their land was suitable for residential use does not depend, as the ALJ suggests, on whether "no insurmountable obstacles" to residential use exist. (ID p. 114) Instead we must determine whether as a practical and financial matter residential use of the land was a suitable, feasible undertaking. Similarly, our consideration whether respondents misled consumers as to the suitability of [54] their land for farming and ranching does not end with the ALJ's finding that some "individuals have taken substantial strides toward self-sufficiency." (ID p. 115) Instead, as above, we must consider whether the land was practically and economically suited for these uses and whether evidence about impediments to agricultural use belies the particular land use and self-sufficiency representations respondents made. We now turn to an examination of the evidence in the record on these points, considering first the availability and cost of water and utilities, then the land's suitability for the three uses represented, and finally the sufficiency of the information respondents disclosed to consumers.

(Holtz Tr. 3064), so for this land to be used as a commercial ranch again would require the accumulation and joinder of hundreds of parcels and the assent of all their owners.

1. Availability and Cost of Water

The center of disagreement over water is not whether an adequate supply was physically available, but whether it was available at a cost that made the represented uses of the land economically feasible. The ALJ made extensive findings as to the testimony about well costs for residential and farming purposes. (ID 224–53) Estimates of what it would cost to put in a well were made by several witnesses. Most stated that the price of a well to supply water for domestic needs would be between $5,000 and $10,000. (Wharton Tr. 3577 ($7,000 to 8,000 in 1980 for commercial driller); Holtz Tr. 3098 ($5,000 to $10,000); Muller Tr. 3637 ($10,000 in 1980 for 600-foot well); Sanchez Tr. 3700 ($10,000 to $12,000 for commercial driller)) However, Kritzler testified that the cost would be somewhat lower, in the range of $4,000 to $7,500. (Kritzler Tr. 628) **[55]** Costs for running a farming or gardening operation were estimated to be higher because of the need for water to irrigate. The large well hole and more powerful pumps needed for a five-acre farm would cost between $10,000 and $20,000. (CX 532; Stanton Tr. 3153)

We conclude that the costs of drilling wells to supply water to the subject properties would range from $5,000 to $10,000 for domestic use and from $10,000 to $20,000 for irrigation purposes.

2. Availability and Cost of Utilities

As the ALJ noted, the physical availability of utilities on the land respondents sold is not in issue. (ID 159) However, we must consider the availability of utilities from a practical standpoint in view of their costs. The ALJ's findings on installation and service costs for electricity, telephone service, and propane gas allow us to determine the range of outlays land owners would encounter. (ID 159–88)

In 1979 the local electric company charged 75 cents per foot, or $3,960 per mile, to extend its lines from existing lines to individuals on the subject properties who wanted to obtain service suitable for a residence.[46] (ID 164) The company **[56]** extends electric lines one-fourth mile free for each meter that the customer installs. Some of the parcels respondents sold are two or three miles away from the nearest line, while others are within the one-fourth mile free distance. (ID 166) Thus the initial costs of electricity installation in 1979 would have ranged from $20 (minimum charge) to $11,880 (three miles).

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[46] The record is not clear as to what the company charged in earlier years. Respondents assert that it was 55 cents per foot "[a]t the time respondents were selling the property" (RAB 31) and this is the cost figure respondents included in their GVA and GVA II brochures. (CXs 83C, 85C) However, the electric company employee who testified answered a question as to what the lowest charge was he could recall by stating that he remembered a 55 cent per charge "somewhere back down the line." (Gwartney Tr. 1214–15) It thus appears that the charges for electric service were between 55 and 75 cents per foot during the period respondents marketed land at SWS, GVA, and GVA II. At the lowest rates, 55 cents per foot, the company would have charged $2,904 per mile to extend its lines, compared to $3,960 per mile at 75 cents per foot. This cost was credited to the customer's electric bill over a period of from 18 months to seven years, depending on the cost of the extension (CX 434), so that customers who used enough electricity would in effect pay nothing for the installation apart from the opportunity cost of advancing that sum to the electric company for expenses to be incurred several months or years later. Customers who left the property in the five-year period before the "credit" was used up or who did not use sufficient electric service, however, would forfeit the remaining balance to the electric company. (Gwartney Tr. 1201)

Installing electric lines adequate to meet commercial irrigation needs is even more expensive because extensive irrigation requires heavier duty, three-phase electric lines. In 1979, consumers would have paid up to $5,808 per mile to have these lines installed, or $17,424 to the furthest lots. Monthly electric charges to run motors needed for irrigation are also substantial. The company's maximum charges in 1981 for a 50 horsepower motor used for irrigation were estimated to be $1,256 per month, while the maximum charges for a 100 horsepower motor were estimated to be $2,512 per month.[47] (Gwartney Tr. 1212–13)

The ALJ determined that costs for extending telephone service to most of the properties is "considerable." (ID 176) **[57]** While the utility company's policy for extending service lines is similar to that for electricity, existing telephone lines are typically somewhat further from the subject properties, so that the maximum costs are higher. Moreover, the charge is not credited against monthly service.[48] An extension to one unit of GVA would cost at least $6,600, and a five-mile extension would cost $11,880. (ID 176)

An individual or family living on the properties who did not wish to use electricity for heat and hot water could use either natural gas or propane gas. Extending natural gas service would cost from $5,000 per mile for residential service to $6,000 per mile for commercial service, with lots from four to seven miles away. (ID 180–82) A propane tank suitable for domestic service costs $460 plus $70 in installation costs. (Harris Tr. 3018) A larger propane system for commercial purposes could be purchased and installed for between $975 and $1,489.

The complaint also alleged that the high cost of obtaining financing, equipment, improvements, and other amenities on the land made it unsuitable for use as homesites, farms or ranches. We disagree with the ALJ's finding that the record contains **[58]** little evidence regarding the unavailability of financing. We believe the record demonstrates the difficulty of obtaining financing on the land.[49]

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[47] Evidence as to charges for motors of these sizes in earlier years does not appear in the record.

[48] Respondents state in their appeal brief that telephone installation costs are refundable against telephone bills, but they do not cite to any evidence establishing that proposition. (RAB 33) Our review of the Initial Decision and the testimony of Ronald Ethridge, Customer Service Manager of Continental Telephone Company (Tr. 2763–94), indicates no basis in the record for this contention. Rather, it appears that telephone line extension costs are not credited against monthly service; instead "it is a one-time fee." (Ethridge Tr. 2779)

[49] The testimony of Ronald J. Stuard, branch manager of a local savings and loan, established that the bank denied loan requests by a dozen landowners and had a policy of refusing loans where property at SWS, GVA, or GVA II would be used as collateral. (Stuard Tr. 3129–31) This was because, in the bank's view, the cost of utilities was too excessive to warrant a loan and because the bank feared that the land could not be sold in a foreclosure

(footnote cont'd)

With respect to the unavailability and cost of other amenities, evidence in the record shows the cost of equipment needed to run small and large farming operations. As the ALJ found, ordinary landowners cannot afford the sort of equipment used on large farms but can afford the size and type of equipment appropriate to farms of five to forty acres. (ID 256–57) There is also evidence that the golf course respondents promised to build on SWS was built, washed out by floods, rebuilt, ruined by drought, and then not rebuilt, in part because of the low level of owner interest in it. (ID 262–68) Respondents made some efforts to stake parcel boundaries as they had promised GVA and GVA II landowners. However, several witnesses testified that their lots were not staked and that they had difficulty finding them or determining their boundaries so that fences could be installed. (ID 273–75) The record indicates that roads which **[59]** respondents promised to construct were in fact built. (ID 280–81, 285–88) By contract respondents were not obliged to maintain the roads at GVA and GVA II. (ID 279, 286)

Finally, the complaint alleges that other of respondents' practices made the property they sold unsuitable for use as homesites, farms and ranches. Complaint counsel's case on this allegation relied principally on respondents' failure to maintain improvements on the land and their practice of allowing cattle to graze on the properties. Improvements to the land, including a golf course and roads, are discussed above. With respect to respondents' leasing of the land for grazing, we cannot accept the ALJ's conclusion that this practice did not impair owners' use of the land. (ID 292) His conclusion stemmed in part from the view that owners could install fences to keep cattle off their property. But given the acreage of these parcels, fencing is an expensive undertaking. The record shows costs of $2,500 per mile to install fences on the property. (Holtz Tr. 3065)

3. Suitability for Use as Homesites

We do not dispute that respondents' land is physically capable of being used as a homesite, that utilities are physically available to be installed at the sites, and that some consumers reside on their parcels. But it frames the issue too narrowly to focus only on the land's physical capabilities and the theoretical availability of utility service without regard to economic realities and the disincentives that extremely high costs presented to owners who wished to develop and improve the land in order to make it physically appropriate for the sort of **[60]** residential use respondents promised. It is probably not possible or

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proceeding for the amount the purchaser had invested. (Stuard Tr. 3131–32) Two consumers who unsuccessfully sought loans from financial institutions in the Van Horn area also demonstrated that loans using the property as collateral were not available.

desirable to establish a bright line beyond which development costs make use of land for a particular purpose impractical. However, from the evidence in this record, we conclude that any sensible analysis shows that the inordinately high costs to provide water and utility service to the land at issue here render the land unsuitable and financially impractical for residential use as respondents represented.[50] We therefore find respondents' representations about the land's suitability for use as homesites misleading because they inaccurately portrayed the economic suitability of the land and its investment value.

The critical limitations on the land's fitness for use as homesites stem from the costs of preparing it for such use. While we have not determined the "average" or typical expense of **[61]** developing a parcel, we have considered the range. Respondents suggest a cost of $8,500 to install a well, electricity, and a septic tank; housing and telephone service[51] would be additional. (RAB 33) On the other extreme, for parcels more removed from existing utility service and for owners desirous of a more traditional homesite, a consumer's expenditure might well exceed the $50,000 estimated by the ALJ. The total expenses consumers could encounter include the cost to drill a well, provide a septic tank, extend electric and telephone service, provide propane gas, and fence the property to keep out grazing cattle.

These costs should not be evaluated in the abstract, however, but should be related to the representations respondents made. Respondents did not market their land as suitable for spartan or subsistence level living. The brochures depicted instead large, developed, irrigated homesites with substantial houses described as "country estates." The expense of developing **[62]** the property for this sort of use would, we conclude, be on the high end of the scale, particularly for those sites some distance away from existing utility lines and for those who expected a large country estate to have a telephone on it.[52] In view of these representations, we do not find evidence of a few consumers who either absorbed the high costs of utilities or avoided them by doing without in order to live on the land in mobile homes persuasive evidence that the land is suitable—practically and financially—for use as homesites in the fashion respondents represented.

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[50] Complaint counsel argue that the fact that only a few purchasers live on the land confirms that it is not suitable for residential use. (CCAB 26) But many consumers were told the land was a good investment that should be purchased for its investment value, and many did indeed purchase for these reasons. The fact that most consumers who purchased a lot chose not to live on it therefore does not necessarily demonstrate that the land is unfit for that purpose. Similarly, the refusal of various local financial institutions to accept the land as collateral for loans to finance construction does not, in our view, establish that the land is unsuitable for residential use since, as respondents argue, financing may be available through other sources. (RAB 36; ID 255) Indeed, this evidence reflects less on the practical and financial suitability of the land itself for use as homesites than on the relatively low market value of the land compared to its selling price, supporting our conclusion *supra* that representations about the land's value as a good, low-risk investment were inaccurate. Accordingly, our conclusions about the land's unsuitability do not rest on these arguments.

[51] Respondents in their appeal brief "caution" the Commission "that it would be an improper exercise of Commission expertise to determine in the absence of evidence that consumers will believe a telephone is a necessity. It must be considered that the people who choose to live on these properties do so in part to avoid such things as telephones. . . . These are not people who consider it important or desirable to have a telephone ringing at all hours." (RAB 32 n.23) Respondents may or may not be right in their characterization of some of the "people who choose to live on these properties," but we do not need to determine that telephone service is a necessity in order to consider its expense in determining the suitability of these parcels as homesites for personal use or investment and resale purposes. To the extent the cost of telephone service is sufficiently high, information as to its expense may need to be disclosed to avoid misleading consumers deciding whether to buy this property for the represented uses.

We note that this result is consistent with the Commission's decision in *Horizon Corp.*, 97 F.T.C. 464 (1981). There we found that costs of drilling a well in one development which could be "as great as" $12,500 contributed to a determination that utility costs were "prohibitive to the ordinary consumer." *Id.* at 830; *see also id.* at 728 (Initial Decision). At another development considered in *Horizon*, well costs of $3,500 to $5,000 contributed to a finding that utility costs were "prohibitive." *Id.* at 834 & n.47. At a third development, well costs of $4,500 supported a finding that utility costs were "prohibitive." *Id.* at 836 & n.52. Similarly, costs of up to $31,680 to extend utilities to properties four miles from existing lines, and costs of $10,000 per mile to extend electricity service, were considered **[63]** unacceptable. *Id.* at 834 n.47, 836 n.52. The total expenditures the ALJ found consumers would encounter in preparing to live in mobile homes on the property were "well under $50,000." (ID 295) Even accepting this estimate (which would be low for many consumers' parcels), the amount of money required approaches the level we found to be "prohibitively expensive" in *Horizon.*[53]

4. Suitability for Use as Farms

The record is replete with evidence that the land at SWS, GVA, and GVA II is fertile and, with irrigation, can produce a wide variety of crops. (ID 297–315) Yet there is also considerable testimony about the difficulty and risk of farming in that area. (ID 328–34) Vegetable farming in Culberson County for other than personal consumption appears to be very rare. Less than one percent of the land in the county is being farmed and there are only 16 to 17 "commercial" farms in the county. (Holtz Tr. 3034, 3042) Several individuals have tried vegetable farming, but testimony indicated only infrequent financial success. (Gunter Tr. 2900, 2906, 2890) The difficulties of climate, pest control, flooding, and the critical need for **[64]** irrigation mean that farming in the area is risky and requires extensive experience. (ID 329–30; Harlow Tr. 2935) Although the county agricultural agent believed that many vegetables could be grown commercially, he testified that the smallest parcel on which an individual could farm profitably as a commercial venture is 350 acres. (Harlow Tr. 2987, 2955; *see also* Holtz Tr. 3054 (300 acres needed to "make a living" farming); ID 327) The record reflects the virtual absence of any local market for produce. (ID 331; Harlow Tr. 2951) The nearest market for vegetables is in El Paso, 120 miles away. (ID 331)

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[52] In light of these depictions of the land being used for residential purposes, we find unhelpful respondents' estimates of the costs of residential use for a consumer living in a mobile home without a telephone. (RAB 32 nn.23, 24)

[53] *Id.* Respondents argue that the total costs to develop a lot in *Horizon* could have been as much as $500,000, so that that case is not comparable. (RAB 35) While it is true the potential development costs at one Horizon property might have been that high, costs at other properties were not. For example, at Arizona Sunsites the cost of water and electricity service could have been up to $36,680 for a parcel four miles from existing lines. *Id* at 834 n.47. At Whispering Ranch, water and electric service to a parcel one mile from existing lines would have cost $17,500. *Id.* at 836 n.52. Respondents appear to have overlooked these portions of our decision in *Horizon* as well as our conclusions that utility costs at Arizona Sunsites and Whispering Ranch were "prohibitive."

It thus appears that profitable commercial farming is at best a risky endeavor on large size parcels. Whether farming for a profit is feasible at all on smaller parcels of the size sold by respondents remains a highly contested question. The ALJ made extensive findings as to farming pursuits that could be profitable on smaller parcels and then concluded that some individuals had taken "substantial strides towards self-sufficiency." (ID 335–55 and p. 115) However, it does not appear that any individual actually makes a living off the land. Moreover, the evidence as to potential small acreage farming uses persuades us that the land is not financially and practically suited for profitable farming operations and economic self-sufficiency.

We have already considered the costs of utilities, water and other improvements as they pertain to development as a homesite. Costs for developing a farming operation—or even a gardening operation—are of course higher than for development **[65]** simply as a homesite, because of increased water and electric use demands. Consumers face costs of $10,000 to $20,000 for a well large enough to serve irrigation needs and expenditures of $17,424 (in 1979) to $26,928 (in 1981) for a three-mile extension of electric lines suitable for irrigation uses (though some of the latter expenditures might be offset against consumption costs). Added to these substantial utility costs are the costs of buildings and equipment that would be needed to engage in a farming operation, which could range from a few hundred dollars to $4,500. (Wharton Tr. 3617; CX 532) Also increasing the total costs are the high monthly charges for running irrigation motors and the expense of installing a fence to keep out grazing cattle. A consumer's outlays for water, electric service and equipment necessary to farm the land at SWS, GVA, and GVA II could thus far exceed $50,000.

We believe these unusual and steep developmental costs for parcels of the size respondents sold make the land impractical and unattractive for the sorts of small-scale farming operations respondents represented. On a large-scale commercial farm, expenses of this level might be warranted since they could be spread over much larger acreage and production.[54] But respondents here represented that consumers could live on the land, producing enough food to meet their personal needs and to sell to others in a fashion sufficient to sustain at least **[66]** subsistence level living. It was inaccurate and therefore misleading to represent the land in this manner when these uses could require initial development expenditures greater than $50,000 and when the risks and costs of farming in the area and the absence of local markets for produce mean that revenues from farming may be small or nonexistent.

The ALJ relied heavily on evidence of consumers who were living on the land and producing some food. However, the testimony of these witnesses makes clear that even after the land had been developed and substantial expenses had been incurred, their personal consumption needs were not completely satisfied. These consumers were, moreover, atypical in that they managed to avoid the costs of drilling to obtain water on their parcels, a practice most purchaser would be unable to repeat.[55] Similarly, the nearby Powell Farms, cited as producing a wide variety of crops, was apparently in financial difficulty and not making money. (ID 298; Compere Tr. 3465)

The ALJ also pointed to other record evidence shedding light on the earnings landowners could expect from using small parcels **[67]** of the land to raise pecans and grapes.[56] The ALJ found that after five years during which there would be no profits, farmers could make $1,000 to $1,500 per acre by raising and selling grapes. (ID 343–45) However, initial expenditures of $70,000 plus the cost of a well would need to be made, and profits would be far from certain because of the risks involved in production and because there is no market for grapes in the Van Horn area. (ID 345; Campbell Tr. 3671, 3673–74, 3678–79) Similarly, the ALJ found that pecans would yield a profit but not until the sixth year of production and then only in amounts of $462 per acre, and $600 per acre the following year. (ID 350) In view of the high initial development costs required to prepare the land for farming, the risks of farming, and the lack of a ready market, we are not persuaded that this testimony on the theoretical profits to be made from raising grapes and pecans on the land establishes that these lots can provide consumers with subsistence level self-sufficiency in a practical and financial sense.

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[54] Indeed, testimony in the record as to the minimal acreage needed for commercial farming reflects the fact that high capital costs must be offset against large volume for the undertaking to be profitable.

[55] One consumer with "extensive experience" in farming raised enough vegetables in a 40- by 15-foot garden to supply half of his diet. (Wharton Tr. 3582, 3585) This was accomplished by using water from a nearby well on respondents' property so that the expenses of irrigation were avoided. (Wharton Tr. 3603) This consumer also described plans to raise chickens, hogs, corn to feed the hogs, and a calf sometime in the future. (Wharton Tr. 3585, 3590, 3595) Another witness, a SWS employee who also used water from a well drilled by respondents, testified that he was not self-sufficient but that his quarter-acre garden permitted him to live on a salary of $900 per month. (Gilmore Tr. 984)

[56] The ALJ appears to agree that such exotic plants as guayule, jojoba, and euphorbia may not be grown for profit in this area. (ID 357–68)

As we noted above, respondents also promoted their land as a good investment because of the farming activities they claimed could be undertaken on it. However, the record evidence from knowledgeable witnesses is that the minimum acreage for a commercially profitable farm is 160 to 400 acres and the average farm size in the area is approximately 1,400 acres. (ID 327) Moreover, respondent Kritzler testified that growing crops on **[68]** small acre parcels is not commercially feasible. (Kritzler Tr. 633–35) These facts establish that small parcels of respondents' land would not be a good investment to resell to others interested in commercial farming operations, since literally hundreds of such parcels would have to be patched together to reach a minimum size for commercially profitable farming pursuits. Nor is the land a good investment for resale to others interested in small-scale farming and self-sufficiency, since the costs and risks associated with such farming are such that the land in its undeveloped state is not practically suited for these uses.

We conclude that respondents' representations that its land is suited for small-scale farming uses sufficient to meet personal needs and to sustain subsistence level living were misleading because they were inaccurate. We also conclude that in suggesting that the land's potential use for farming enhanced its investment value, respondents inaccurately protrayed its worth and risk as an investment.

5. Suitability for Ranching Uses

Respondents claimed that the parcels they sold could be used to raise one or two head of cattle—or enough to provide beef for personal consumption—because cattle can graze on the property. Yet the record indicates that this arid, semi-desert land is capable of supporting only six to ten head of cattle for each 640 acres of grazing area. This means that between one-twentieth and one-twelfth of a cow could be raised on a five-acre parcel of land. **[69]**

Cattle can of course be raised on the property, but only by importing feed and providing them virtually "everything they eat" by "running a miniature feed lot," which is expensive. (Holtz Tr. 3065) We find it is misleading to suggest to prospective purchasers that cattle can be raised on the land when this is only true if consumers purchase and feed the cattle most of their needs. Indeed, one might well claim that a five-acre parking lot was suitable for raising cattle if the accuracy of marketing claims were so evaluated.

Respondents contend their claim that one or two head of cattle may be raised on the land is true and is proved by the testimony of Mr. Sanchez, who "with eighty-eight acres in GVA is currently raising twenty-five cows," and Ms. Smallwood, who "raised as many as five or six horses on ten acres in GVA." (RAB 46) Respondents' wording of the statement about Sanchez conceals one important fact: Sanchez is not raising 25 cows on 88 acres. Mr. Sanchez does own at least 80 acres in GVA, and he does own 25 cows. (Sanchez Tr. 3688–89) But he does not raise the cows on his 80 acres because they are allowed to roam over the entire GVA parcel so that in effect he is raising 25 cattle on up to 15,000 acres of GVA. (Buck Tr. 1531; Sanchez Tr. 3708) As a practical matter, if more than a few consumers raised cattle on GVA it would soon be unable to support them since the entire property is only 15,000 acres which could sustain only a few hundred head of cattle under the ratio set out above. As for Ms. Smallwood's testimony, she lived on the land only six months a year, which casts doubt on respondents' assertions that horses **[70]** were "raised" on the land. In addition, it is simply not credible that "five or six" horses were raised on 10 acres of land without supplemental feed.

The ranching use representations respondents made to consumers also communicated that the land was a good investment because it could be used for ranching and presumably sold to others who engaged in ranching. Respondents Gross and Kritzler conceded, however, that commercial ranching on the parcels was not practicable. (ID 158) According to one witness, the minimum acreage required for commercial ranching is 10,000 acres, which will support 100 head of cattle and provide a very low income. (Holtz Tr. 3063–64; ID 369) Ranchers interested in buying this land for ranching purposes would thus need to combine hundreds or possibly thousands of lots to secure a sufficiently large area to sustain grazing cattle, making this a difficult and unattractive investment alternative. (Conoly Tr. 1060) Moreover, the record reflects that large acreage ranch land is generally valued and sold at prices much lower than consumers here paid,[57] so that resales of this land to others interested in commercial ranching would be unlikely, at least at prices allowing consumers any profit on their sales. We therefore conclude that respondents' ranching and investment-related representations inaccurately **[71]** described the land, its suitability for raising cattle, and its value as an investment stemming from its potential for ranching activities.

6. Disclosures of Information

Respondents generally did not disclose to consumers the costs per unit to install various utilities, the estimated costs of bringing services to the parcels consumers were considering buying, or the estimated costs of bringing service to the furthest parcels. This information does not appear in respondents advertising scripts and the subject was apparently avoided in oral sales presentations by respondents and their brokers.[58] Similarly, respondents' written materials generally **[72]** do not disclose information about the costs of utility service with the exception of the fact sheets, discussed *infra*, which contained some information about utilities but little about costs. Nor did respondents alert consumers to the factors concerning the unsuitability of the lots to be used as respondents represented for homesites, farms, and ranches. Respondents simply did not reveal orally or in writing the risks associated with the land uses they promoted.[59]

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[57] Complaint counsel's experts placed the value of rural ranch land at well below $100 per acre. Martha Conoly valued respondents' property as rural ranch land worth between $50 and $75 an acre. E.T. Compere valued respondents' land, if sold in large tracts, at between $35 and $80 an acre. (ID 400, p. 98 n. 67).

The ALJ concluded nevertheless that the information respondents supplied was sufficient to permit consumers "to inquire further, depending on their interest." (ID p. 114) The effect of this reasoning is to remove from the developer the burden of disclosing significant facts about the property by simply providing addresses of utility companies and other **[73]** innocuous information, such as that contained in the fact sheets, even after the developer has promoted the land as suitable for various uses for which high utility costs might be encountered. Information of this nature is clearly critical to consumers contemplating a purchase decision.[60] Consumers who desired to use land they bought as homesites might have reconsidered had they known that telephone service, electric service, water and other amenities could be extremely expensive, especially relative to the cost of the lots. The same is true for consumers planning to use their land for small-scale farming and ranching; information about very steep initial development costs to prepare the land to farm and the high risks of raising crops in the area, and knowledge of the need to provide expensive supplemental feed to engage in ranching on the property, may well have deterred those purchasers who believed these activities could be pursued easily and cheaply and with little additional expenditure over the purchase price of a lot.

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[58] Respondents' policy as to what information on development costs would be presented by its sales personnel was summarized by Ted Rose, who was the sales manager in respondents' Houston office:

> Q: Aside from the information in the fact sheet, it wasn't your policy or the policy of the subdivider respondents that you would disclose . . . information [on costs other than that in the fact sheet] to consumers?
>
> A: No sir. We always looked at it—*we tried to oversimplify it*, and that is the way we treated it. We were in the land business. We were selling land. That is what we advertise, and that is what we sell. We didn't sell utilities nor water wells or anything else. We sold them a piece of dirt. And if they wanted to know anything about drilling water wells, they were told to contact the local well driller, whenever they go out there and see their property.

(Rose Tr. 713–14 (emphasis added)) Sales representatives would have found it difficult to supply this information if they had wanted to since they simply did not have it. Indeed, one sales representative testified that he had "no way of knowing" the costs of utilities. (Novaez Tr. 870) Respondents' brokers had even less ability to provide this information when asked. The telephone scripts they used (CXs 123–125) confirm that information about utilities and their cost usually was not provided to prospects orally. (*See also* Porter Tr. 2333–36). In addition, Porter Realty sales representatives had no information about the cost or availability of utility services other than what was in respondents' fact sheets. Sales representatives were not instructed to disclose the costs of utilities and did not know what they were. (Porter Tr. 2336) None of Porter Realty's sales representatives ever visited the land they sold. (Porter Tr. 2262)

[59] Potential buyers who expressed an interest in using the land to raise produce were not advised of the expenditures that had to be made to undertake that activity, although sales representatives showed consumers a report (CX 220) stating that the soil was fertile and materials indicating that farming was a suitable way to use the land. (Hammer Tr. 667) Potential buyers who expressed an interest in using the property to raise cattle also were not advised of the costs of that activity. (Hammer Tr. 669) Respondents' advertisements and promotional materials were also silent on these points.

[60] Indeed, one of respondents' employees testified that one common reason purchasers gave for requesting refunds was that the land was "too expensive to develop. It was going to cost more than they had the resources to develop. . . . [T]hey found it cost too much money." (Novaez Tr. 894) This strongly supports the notion that consumers consider information about the costs of development material to their purchase decisions.

These beliefs were encouraged by respondents who represented the land as suitable for these uses in a practical and financial sense and, moreover, promoted it as a good, valuable investment. Numerous statements along these lines appeared in respondents' advertising and promotional materials. To further **[74]** communicate the point, respondents showed consumers pictures of improved and irrigated land (for which the substantial costs of development had already been made) to demonstrate in graphic, visual form how the land could be used for the purposes stated.[61] In this context, costs of development that could be two to ten times the cost of the land are costs that purchasers could not be expected to anticipate, yet that could make a difference in their decisions whether to purchase the land, which lot to buy, and what price to pay.[62] **[75]**

Respondents argue that to the extent disclosures about the costs of utilities and other amenities were needed they were made in the fact sheets consumers received before purchase. (CXs 79 to 85) We have reviewed these materials carefully and conclude that they do not provide the sort of information necessary to dispel the misleading impression respondents conveyed to consumers about suitable uses of the land. The record also establishes that respondents' policy was to avoid providing additional cost information to prospects in oral sales presentations. The fact that such information was not supplied or known to many of respondents' and their brokers' sales representatives ensured that the information consumers received was limited to the written fact sheets, which we find were inadequate.

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[61] The fact that many of the pictures respondents used were not of their property may have further distorted respondents' representations, creating an additional need for disclosures of developmental and cost limitations. (Smallwood Tr. 4059; W. Smith Tr. 358, 961-62) We also observe that the strong visual and verbal claims respondents made about the land's value and potential uses could have dissuaded consumers from engaging in further search efforts to determine for themselves how valuable the land was and how they could use it. This, too, suggests a pressing need to disclose this information to consumers.

[62] Respondents attach some importance to the ALJ's finding that the record does not reveal any consumer who was deterred from using the land because of the high costs of water and other utilities. (RAB 31) Respondents mischaracterize the finding as concluding that costs never had and never would deter any consumers when in fact the ALJ concluded only that there was no record evidence that this had happened. (ID 170) In view of the fact many landowners purchased for investment purposes rather than for personal use, it is not surprising that no evidence was introduced of consumers whose plans were derailed because of unanticipated expenses. In any event, we need not determine whether any consumers *actually* were misled by respondents' practices. *See American Home Products Corp. v. FTC*, 695 F.2d 681, 687 (3d Cir. 1982); *Trans World Accounts, Inc. v. FTC*, 594 F.2d 212, 214 (9th Cir. 1979); *Raymond Lee Organization, Inc.*, 92 F.T.C. 489, 626-27 (1978), *aff'd*, 679 F.2d 905 (D.C. Cir. 1980).

The fact sheets disclosed estimated costs to install desired services only with respect to installation of a septic tank, which at estimated prices of $500 to $1,000 may be one of the lowest expenditures users of the land must make. Information about the water supply and other utility services was limited to incomplete clues that would assist consumers only marginally in determining for themselves what expenditures might be required. For example, respondents disclosed in the fact sheets the address of the local electric utility company and, in later versions of the fact sheets, a summary of some of the company's charges for **[76]** providing electric lines.[63] But respondents' sales approach ensured that consumers did not have the time or the ability to learn the cost of bringing services to their parcels before a contract was signed.[64] The clues respondents included in the fact sheets about other utility services are even less adequate than those relating to electricity.[65] And, though respondents **[77]** did disclose to purchasers that the land was leased for grazing, they did not mention the substantial costs to install fencing to keep cattle off individual parcels.

Respondents also insist their disclosures were sufficient because, given the variances in cost to provide service to different parcels, they disclosed all that could be disclosed. (RAB 37) Yet respondents did not disclose either enough information for consumers to figure out for themselves the actual costs they would face or the range of costs to different parcels, including the maximum possible. The fact that costs vary does not make this information any less critical and, indeed, it may make it even more important. Respondents had available to them more precise information on water and utility costs. Even considering the variable level of these costs, respondents could have informed consumers of the magnitude and range of expenditures required to develop the land. Their failure to do so represents a failure to disclose material information needed to correct misimpressions they conveyed to consumers and therefore amounts to a misleading practice.

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[63] The SWS fact sheet did not disclose either the cost per foot or the distance of the furthest lots from existing lines (up to three miles). (Gilmore Tr. 1018) Two GVA fact sheets disclosed that the furthest lot from existing services was two miles. (CX 83C, 85C) In conjunction with the explanation of installation charges at $0.55 per foot after the first one-quarter mile, it was possible for consumers to perform a series of calculations to discover that the fee for providing service to a parcel two miles distant was $3,890. In view of the volume of other information provided to consumers with this information and the magnitude of the expense, we find respondents' disclosure inadequate to warn consumers that obtaining electric service could be extremely expensive.

[64] Signficantly, many of respondents' customers lived outside of Texas, sales were made through mail or telephone transactions (Porter Tr. 2325; Kritzler Tr. 566), and most purchasers never visited the land (Gilmore Tr. 491; Novaez Tr. 896; W.D. Smith Tr. 939). This means that buyers could not easily gather information about the parcels from sources other than respondents. Moreover, the only information the contracts contained about the location of individual parcels was the unit or parcel number. (CXs 74–78). Consumers who did not know how far their lots were from existing electric lines would have been unable to compute the company's charges for providing them with service.

[65] With respect to water, the fact sheets stated that piped water was not available and noted that wells could be drilled instead. Costs of drilling were not disclosed; the fact sheets stated simply that the cost per foot varied with the driller and the water table. The fact sheets all discussed the absence of an "in-tract" natural gas system and advised consumers to contact various bottled gas companies for information. No addresses were given, though there is only one such company in the area. (Harris Tr. 3017) No information about costs was provided. All of respondents' fact sheets also referred to telephone service. Buyers were advised to contact the telphone company and an address was provided. No cost estimates for installation of telephone service were given.

The complaint charged respondents with failing to disclose "material facts" about the land's suitability for use as homesites, farms, and ranches. In addition to the development costs outlined above, complaint counsel cite other undisclosed material facts. With respect to use of the land as homesites, these include the lack of financing and the uncertainty of **[78]** economic development in the area. With respect to potential farming endeavors, complaint counsel cite the high farm costs involved and the lack of a market for various crops. With respect to potential ranching uses, undisclosed facts include the need to supply ranch animals with the bulk of their dietary requirements.

The record contains evidence both of the inability of consumers to obtain financing using their lots as collateral and their ability to obtain loans in other ways. Respondents did not make representations about the availability or cost of financing improvements to the land they sold. In addition, the record does not reflect that financing of development costs through loans on the undeveloped land is a common or expected procedure in this area or elsewhere, and we are unable to so presume. In our view, the land's virtual uselessness as loan collateral reflects more on its poor value and lack of resale potential than on its unsuitability as a homesite. We cannot conclude that respondents misled consumers in failing to disclose the unavailability of financing on the land.[66]

Material facts complaint counsel allege were not disclosed in connection with farming land use representations include associated costs and risks. In assessing the land's suitability for use as farmland we found that farming is a risky, difficult, and expensive proposition in the Van Horn area. We also found **[79]** that raising grapes and pecans on the property as respondents suggested entailed considerable risks, substantial initial development costs, and a low return after several years without any profits. We found that there was virtually no local market for produce in the area. All of these factors posed significant obstacles to consumers' ability to use their land profitably for farming, to produce food for their own consumption, and to become self-sufficient. Because respondents represented the land was suitable for these uses, consumers would not have anticipated that such significant barriers to use existed; respondents' failure to disclose these costs, limitations and risks were, accordingly, misleading.[67]

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[66] We also are unable to conclude that respondents' practices in constructing and maintaining roads and the golf course at SWS misled consumers.

Finally, we believe respondents' ranching land use representations were misleadingly incomplete. Respondents failed to disclose to prospective purchasers material information needed to correct misimpressions they created about use of the land for ranching. In reviewing the accuracy of respondents' ranching representations we concluded that even one or two head of cattle **[80]** could not be sustained by grazing on land of the acreage respondents marketed. Respondents claimed that cattle could be raised but did not inform consumers of the additional feed expense that would be required to do so, since the land itself cannot produce sufficient food without irrigation and cultivation. This omission, in our view, rendered respondents' ranching claims misleading. **[81]**

E. *Unfairness Count*

Count III of the complaint alleges that respondents engaged in unfair trade practices by inducing consumers to purchase and continue paying for land of little or no value for the uses represented, through means of collection letters, prepayment discounts, and deceptive representations about the land. Count III further alleges that respondents' receipt and retention of money in these circumstances is unfair. The record establishes (and respondents appear not to dispute) that respondents induced consumers to purchase land and to continue making payments on it through various representations made orally and in writing.[68] We have declared elsewhere in this opinion (Section II.A., C.) that those representations consisted of claims that the land was a good investment and could be used for residential, farming and ranching pursuits, and that those representations were inaccurate and incomplete. The principal remaining controversy bearing on these allegations centers, then, on the question of the land's value.[69] **[82]**

The ALJ did not make findings as to the land's actual market value, concluding instead that it had "some" value so that its sale did not fall within Count III of the complaint. (ID p. 115) He acknowledged but did not resolve the conflicting assessments of market value voiced by experts for the parties. These conflicts stem principally from two factors: the experts' views as to the use of the land (upon which the assessment of value depends) and their views as to which other transactions in the area could fairly be compared to respondents' land sales.

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[67] Complaint counsel also argue that respondents failed to disclose that the parcels were too small for use as farms and ranches. We do not believe respondents represented to consumers that these parcels could be used for large-scale commercial farming and ranching or that, in the absence of such representations, consumers would have believed the land could be so used. We therefore conclude that disclosures to the effect that the parcels were too small for commercial farming and ranching uses were not needed. However, as we discussed *supra* (Section II.D.4.), respondents' claims that the land was a good investment because it could be used for farming or sold to others for this purpose were misleading since the parcels were so small that hundreds would have to be purchased and joined together to form a farm of minimally feasible size.

[68] There is also some evidence in the record concerning respondents' use of prepayment discounts for these purposes. (CXs 214, 215)

[69] The ALJ cited respondents' "liberal refund policy" as part of his rationale for finding no unlawful retention of money. (ID p. 116) The record discloses that respondents' refund policy was in fact quite limited, allowing cancellation only within the first 60 days and after a personal inspection by the purchaser (but not an agent of the purchaser) and with other limitations. (CXs 74–78) Moreover, the record shows very few refunds, some of which were made only after consumers threatened legal action. (Switaj Tr. 1315; Leuckel Tr. 1842; E. Smith Tr. 2095; Limpp Tr. 1420) This evidence persuades us that respondents did not adequately refund the money they received.

Complaint counsel's expert E.T. Compere believed that, when not subdivided, the land's highest and best use was as ranch land, primarily because that was the predominant land use in the five-county area including Culberson County and because the costs of farming, especially irrigation, made that alternative unattractive. (ID 391–94) In comparing the prices at which other land in the area had been sold, Compere excluded sales of other subdivided land because they did not meet his definition of sales for fair market value. This is because such sales, much like the sales at issue in this case, did not involve "normal," market rate financing or face-to-face dealings; because the selling prices varied greatly from the prices for unsubdivided land and appeared to reflect promotional activities rather than market value resulting from arms-length negotiations between fully informed buyers and sellers; and because lack of demand resulted in no resale market for the subdivided properties (indeed, no records of resales from the original purchasers to subsequent purchasers could be located). (ID 396–97) Using **[83]** instead sales transactions for unsubdivided land as a comparison, Compere assessed the value of respondents' land at between $35 and $80 per acre in large tracts and between $54 and $110 per acre in small tracts. (ID 400) Other evidence supporting complaint counsel's position that the land has little or no value for the represented uses is the testimony of Martha Conoly that the land is worth between $50 and $70 an acre and that no resale market exists, the testimony of a local branch bank manager that the land was not acceptable as collateral for a loan, and the testimony of numerous consumers who were unable to resell their parcels. (ID 254, p. 98 n.67)

Respondents' principal expert witness, Larry Brooks, also looked at comparable properties in the area to determine the fair market value of the land at SWS, GVA, and GVA II. However, he was willing to and did rely on evidence of sales at other subdivisions, including U.S. Properties and Terlingua Ranch. In an effort to ensure that these subdivision sales in fact reflected market value, Brooks surveyed consumers by telephone and with a written form mailed to customers. (RX 78–81) He also inspected the properties to ensure comparability. Brooks then determined the land's value was between $275 and $525 per acre. (ID 413–29)

Having carefully reviewed the competing assessments of value, we accept the conclusions of Mr. Compere as to the fair market value of the land respondents sold and we reject the **[84]** assessment of Mr. Brooks.[70] Respondents' attacks on Compere's testimony are not, in our view, persuasive.

They argue first that Compere's conclusions as to the highest and best use of the land are internally inconsistent, since he testified that ranching is the higest and best use and that the minimum acreage for a ranch is 6,400 acres. Respondents assert that, because their property was sold in five to forty-acre parcels, ranching cannot be its highest and best use. (RAB 47–48) Of course, that is in a sense precisely Compere's point: respondents subdivided the land so that it had little value for ranching because the parcels were too small.[71] What respondents' argument ignores is that the highest and best use as Compere used the term focused on the nature of the land itself (such as its physical characteristics, location, and costs of development, as evidenced by the prior use of the land for ranching), the predominant use of land in that area for ranching, and the low level and unproved productivity of farming in the area. (Compere Tr. 3241–47) Respondents' expert witness agreed **[85]** with Compere's assessment that the land once subdivided into small parcels was not best used for ranching. (Brooks Tr. 4454) Whether the land has value for other uses, and at what price, are issues that the expert appraisers were thus forced to make in the context of the small acreage parcels respondents sold.

Respondents next challenge Compere's conclusion that small parcels have more value per acre than large ones since this allegedly cannot be reconciled with the conclusion that ranching is the land's preferred use when the land consists of large acreage tracts. (RAB 48) Here respondents misperceive Compere's analysis, for he did not value the small acre parcels of land sold by respondents as ranch land;[72] instead he compared the land to other small parcel transactions in the area to assess its value relative to comparable parcels, most if not all of which were sold for purposes other than ranching. Witnesses for complaint counsel and respondents both concluded that parcels sold in smaller acreage tracts have a higher per acre value. (ID **[86]** 400, 429) This is because, as Compere explained, purchasers would be willing to buy one or two tracts at a per acre price higher than they would be willing to pay for large parcels.

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[70] There are admittedly deficiencies in the methodologies and assessments made by both Compere and Brooks. However, Compere's conclusions are supported by Martha Conoly's testimony as to the land's marketability and value. *See*Section II.B.1, *supra.* In addition, Compere's valuations are consistent with the fact that there is no resale market for this land at the prices consumers paid, and his conclusions resolve in a more satisfactory and credible fashion the severe discrepancies that he found in prices paid for various similarly-sized parcels. Brooks' testimony does not, in our view, satisfactorily address these other points.

[71] As complaint counsel note, the problem of "fractionalization" can reduce the usefulness of land for its best uses. (CCAB 39 & n.21; *Horizon Corp.*, 97 F.T.C. 464, 840 (1981).

[72] Indeed, Compere specifically rejected use of parcels five to forty acres in size as ranch land because he found no other similar tracts in the area being used for that purpose. (Compere Tr. 3246) He further stated that he would not have valued the land in those parcel sizes at all except that FTC staff asked him to do so. (Compere Tr. 3276) Similarly, respondents' expert testified that the best use of that land in small acreage parcels was for rural recreation purposes, not for residential, farming or ranching purposes as respondents had represented, since Brooks found those to be less valuable and less feasible uses of the land. (Brooks Tr. 4328–29; 4450–56)

Finally, respondents attack the allegedly arbitrary and selective way in which property sales at other subdivisions were excluded from Compere's assessment of the market value of land sold in small acreage parcels.[73] (RAB 49–50) We believe Compere's exclusion of sales data from subdivisions whose sales prices appeared not to reflect the fair market value of the property was proper. As experts for both parties testified, fair market value means what a willing buyer would pay a willing seller, both parties acting with full information and neither party acting under coercion or duress, and with ample time to complete the sale. (Compere Tr. 3182; Brooks Tr. 4324–25) Sales that do not involve full disclosure of information or that involve misrepresentations about the land simply have no relationship to fair market value and cannot be used as comparables, as respondents' expert agreed. (Brooks Tr. 4489, 4493)

Compere's testimony demonstrates that the sales he excluded bore indications that they were not market transactions at fair market value. The sales he excluded were sales at subdivisions where the land was sold through "promotional" means rather than in face-to-face or person-to-person negotiations, and to absentee **[87]** purchasers. (Compere Tr. 3241–42, 3259, 3394) The marked variations in per acre prices and the higher prices he found for these subdivision sales,[74] which greatly exceeded prices for land not sold on this basis, confirmed his view that the sales prices of those parcels did not reflect fair market value assessments. (Compere Tr. 3188, 3257)

Compere also found that these subdivision sales were consummated with unusual selling terms such as low downpayments, promotional costs comprising a large proportion of the downpayment, large amounts of the selling price carried back by the seller, and below market interest rates. (Compere Tr. 3188, 3259, 3387–88, 3394, 3397–98) These financial concessions indicate that the selling prices probably exceeded fair market value and, again, that promotional activities rather than market forces were responsible for pricing the land. Finally, Compere pointed to the lack of a resale market for subdivision properties as indicating that the selling prices did not represent fair market value. The lack of a resale market was evidenced by his inability to find any deeds recording person-to-person resales of subdivision property (other than respondents' land, with respect to which four deeds were found) and by the universal refusal of realtors in the area to list such property for sale. (Compere Tr. 3259–62, 3398–99) These are all convincing rationales for refusing to consider these subdivision sales as evidence of the fair market value of respondents' property. **[88]**

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[73] In a companion argument, respondents attack Compere's reliance on the Texas Veteran's Land Board sales. (RAB 49–50) We do not find these challenges persuasive.

[74] Compere testified that the per acre prices ranged from $139 to $957 for most of the transactions he reviewed, while the mean sales price was $547. (Compere Tr. 3257–58)

Respondents' expert appraiser took an approach almost exactly opposite to Compere's: he excluded sales of all property except those at two subdivisions that he deemed comparable to SWS, GVA, and GVA II. Although he attempted to determine that prices of the parcels sold in the two comparable subdivisions represented fair market value, the surveys he used turned up evidence of investment sale representations at one of the subdivisions, and Brooks admitted he was not aware of the sales techniques used there.[75] With respect to the other "comparable" **[89]** subdivision Brooks used, he admitted there were a number of significant differences between it and respondents' properties, including that it had an area (perhaps 40,000 acres) set aside for hunting,[76] a swimming pool and clubhouse, a cafe/restaurant, a lodge, and a landing strip, and that it was close to a national park. (Brooks Tr. 4434–35) All of these amenities could increase the value of that subdivision, making it quite dissimilar to the undeveloped property respondents sold.

Another difficulty with Brooks' approach is his determination of the land's highest and best use, which he testified was "rural recreation."[77] (Brooks Tr. 4328) He defined highest and best use as the use that "will generate the greatest net value to the land." (Brooks Tr. 4452–53) Because he found that the land, once subdivided into small tracts, sold for amounts higher than the large tracts used for farming and **[90]** ranching operations, he concluded that those sales represented the land's highest and best use.[78] (Brooks Tr. 4452–54)

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[75] There is some indication that the sales techniques used at that development, U.S. Properties, included misrepresentations. The principal sales representative there, Mr. Bray, had been involved in land sales at Southwest Land Corporation (the prior owner of SWS land), at SWS and at Horizon. (Bray Tr. 3768–70, 3829) Materials he used in other land sales activities include a number of investment-related claims. (CXs 477, 556) At the least Brooks should have investigated further to determine whether misrepresentations were made at U.S. Properties rather than accepting Bray's denial at face value.

We are also troubled by other aspects of Brooks' surveys. First, the low level of responses—some 30 percent of the persons contacted which was only 25 to 30 persons at U.S. Properties (ID 417–20)—makes it difficult to conclude what promotional and selling practices were generally used at these subdivisions. Second, the survey questions posed and the nature of the answers likely to result therefrom do not shed much light on the issue whether misrepresentations were made. For example, none of the surveys asked consumers what representations were made to them about the property or what sales personnel told them. The question closest to this inquired only about the purposes consumers had in buying their land, and Brooks conceded that some consumers listed "investment" in response to this question. (Brooks Tr. 4475) Brooks did not tabulate the consumer responses but complaint counsel's witness, Dr. Michael Mazis, did. (CX 572A, B) To the extent these responses reveal anything, they indicate that many consumers purchased their land for investment-related purposes. Finally, Dr. Mazis identified other significant flaws and biases in the methodology used to conduct the surveys. (Mazis Tr. 4663–78)

[76] Brooks testified that hunting was a rural recreational use for which respondents' land was suited, but he admitted that most hunting on parcels of the size respondents sold would involve trespassing onto other people's property. (Brooks Tr. 4433–34)

[77] We find it revealing that respondents neither marketed the land for these purposes nor argue now that such potential uses give it value. Mr. Brooks' discussion of the highest and best use of the land, in which he considered and rejected farming and grazing activities as the highest and best use, also undercuts respondents' arguments that the land is suitable and valuable for those uses. (Brooks Tr. 4451–55)

We find Brooks' analysis unacceptably circular to the extent it suggests that a seller may, simply by subdividing land and generating a few sales through questionable tactics, transform the land's highest and best use and substantially elevate its value, without regard to the market's acceptance of the transformations the seller purports to have wrought. Such an analysis ignores the central questions governing the assessment of highest and best use, such as what uses the land is physically suited for, how it can be most productive, and whether there is a market for the proposed uses. Moreover, there is much evidence in the record here to suggest that there is little demand—and virtually no resale market—for subdivided land like respondents', except in the context of promotional sales involving misrepresentations to uninformed, absentee purchasers. We therefore cannot accept respondents' arguments that rural recreation is the highest and best use for these properties.

Finally, Brooks' assessment of the value of the land respondents sold does not explain two critical factors: the **[91]** absence of a resale market and the wide disparity in prices paid for land sold through promotional efforts at subdivisions and by contrast for land sold directly in isolated transactions. These two factors cast substantial doubt on the validity of his valuations since land sold for prices at or near its fair market value would, almost by definition, have a resale market and since one would not ordinarily expect the prices for sales of similar property to vary substantially. For all of these reasons, we find his conclusions about the land's fair market value unreliable.

Having concluded that the per acre value of respondents' land when sold in small acreage parcels ranged from $54 to $110 per acre, depending on time and location, (ID 400) we now must consider whether those amounts represent "little or no value" as charged. The ALJ concluded that the properties were "of value" and found no violation of law under Count III (ID pp. 115–16), a conclusion respondents embrace with enthusiasm. (RAB 47) However, we view the question of value as a relative matter. Clearly the land has some value, at least $54 per acre according to complaint counsel's expert. But this amount must be compared to the prices consumers paid, which were of a much higher magnitude, ranging from $600 to $1,200 per acre or perhaps ten to twenty times the land's fair market value. The question of value must also be answered in light of the complaint allegation that the land has little or no value "as an investment, homesite, farm" or for any other use represented by respondents. [92]

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[78] Both parties agree that land in small parcels may command a higher per acre price than land in large tracts. This is because buyers are willing to pay more per acre when they are paying less in total, and because sellers are often willing to pass along to buyers cost savings associated with large acre sales. However, this phenomenon does not establish what the land's highest and best use is, or what its market value is, but only that there may be some differential in per acre prices between large and small tracts.

We conclude that respondents' land has little or no value as an investment since it was sold to consumers at prices many times its fair market value. Property for which consumers paid between $600 and $1,200 per acre, but which can likely be resold for only $54 to $110 per acre, does not in our view meet any sensible definition of investment value and indeed has almost no value for investment purposes. We also conclude that respondents' land has little or no value for the other purposes respondents represented: use as a homesite, farm or ranch. The land's high cost relative to its market value, the steep development costs needed to prepare the land for these uses, and the risks and limitations that attend consumers' use of the land for these purposes all support our conclusion that the land has little value for these uses. Thus, we find that respondents engaged in the practices alleged in count III of the complaint when they induced and retained payments on land of little or no value for the uses represented by employing inaccurate and incomplete representations about the land.

III. LEGAL DISCUSSION

A. *Respondents' Liability for Deceptive Practices*

We have considered respondents' conduct in light of the elements of deception set forth in Commission and judicial opinions, including the Commission's decisions in *Cliffdale Associates, Inc.*, Docket No. 9156 (Mar. 23, 1984) [103 F.T.C. 110] and *Thompson Medical Co., Inc.*, Docket No. 9149 (Nov. 23, 1984) [104 F.T.C. 647]. The Commission stated in *Cliffdale* that an act or [93] practice is deceptive if it consists of a representation, omission or practice that is both material and likely to mislead consumers acting reasonably under the circumstances.[79] We conclude that the practices respondents pursued here in the course of marketing and selling land to consumers were deceptive under this standard and violated Section 5 of the FTC Act.

As we have described in the preceding sections, respondents in this matter made a number of representations about the investment value and potential uses for the land they sold at SWS, GVA, and GVA II that were inaccurate and incomplete. Many of the representations were express, as we have noted, and their meanings clear. We can therefore infer that consumers acting reasonably in the circumstances would have interpreted them precisely as they were made. Other representations were implied and required the Commission to determine how consumers reasonably [94] would have interpreted them.[80] We did so by considering the net impression respondents' claims made on consumers, giving due regard to the influence various express statements had on consumers' interpretations of implied claims, and noting the extrinsic evidence in the record in the form of consumers' testimony as to how they interpreted claims made to them. We also determined that respondents omitted to disclose important facts to consumers. Finally, we determined that respondents' practices were misleading because their representations about the land were inaccurate and because they failed to disclose qualifying information needed to correct misimpressions their actions created. We discuss below the specific complaint allegations of deception.

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[79] Commissioners Bailey and Pertschuk dissented from the use of this standard, arguing that an act or practice is deceptive under Section 5 of the FTC Act if it has the tendency or capacity to mislead a substantial number of consumers in a material way. *See Cliffdale Associates, Inc., supra* (Pertschuk, Commissioner, concurring in part and dissenting in part); *id.* (Bailey, Commissioner, concurring in part and dissenting in part). Commissioner Bailey believes that respondents' practices here were deceptive and violated Section 5 of the FTC Act because they tended to mislead a substantial number of consumers in a material way by presenting respondents' land, inaccurately, as attractive, money-making investment property that was suitable for a wide range of uses and that did not have any significant drawbacks or limitations. She also agrees that these practices were likely to mislead consumers acting reasonably under the circumstances in a material way, though she does not endorse the use of this standard.

1. Count I

We find that respondents represented that the land at SWS, GVA, and GVA II was a good, profitable, safe, and easily resold investment with little or no risk of loss. These representations were made both expressly and by implication.

Respondents expressly represented that purchasers of their land would realize profits within a short time frame, could expect to double or triple their money, and would not suffer any losses on their purchases. The impact of these representations was strengthened by respondents' representations that land in [95] general was a good investment and a good way to make money, particularly because the latter representations were positioned in respondents' brochures and sales presentations in conjunction with extensive pictorial and verbal depictions of respondents' land. Because these representations were express and were in many instances accompanied by explicit factual assurances, consumers reasonably would have interpreted them as they were made.

Respondents also made two types of implied representations. First, respondents represented that oil exploration in the area was under way, that oil companies were moving into the area and might repurchase respondents' land from respondents' buyers, and that increasing oil exploration in the area would lead to the construction of an oil refinery and demand for land for worker housing. Prospective buyers reasonably could have interpreted these statements to represent that respondents' land was a good investment because of the presence of oil and oil-related development. Second, respondents represented that a nuclear power plant and a guayule processing plant (for producing rubber) might be constructed in the area. Because these representations were made in conjunction with written and oral representations as to the value of respondents' land, prospective purchasers could reasonably have interpreted them to convey the representation that respondents' land was a good investment because of the presence or prospect of commercial and industrial development. In summary, respondents impliedly represented that the presence or prospect of oil and oil-related development and **[96]** other commercial and industrial undertakings made respondents' land a good investment.

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[80] It is important to remember that this evaluation does not focus on whether it was reasonable for consumers to believe or act on the representations at issue. It focuses instead on whether consumers could reasonably interpret the advertising or statements to convey the implied representations.

Respondents also failed to disclose to consumers the substantial risks associated with purchasing their land and the difficulty consumers might have attempting to resell it. In light of the affirmative statements respondents made, the absence of these qualifying disclosures could have led reasonable consumers to have misimpressions about the risks of purchasing the land. Respondents' failure to disclose appropriate qualifying information therefore constitutes an omission.

We believe the representations and omissions described above were material to consumers. A material representation or practice is one that is likely to affect a consumer's choice of or conduct regarding a product or service. *See FTC v. Colgate-Palmolive Co.,* 380 U.S. 374, 386–87 (1965); *American Home Products Corp.,* 98 F.T.C. 136, 368 (1981), *aff'd as modified,* 695 F.2d 681 (3d Cir. 1982); *Statement of Basis and Purpose for the Cigarette Rule,* 29 FR 8325, 8351 (July 2, 1964). The Commission infers that all express representations are material. *See Thompson Medical Co., Inc.,* Docket No. 9149, slip op. at 59 (Nov. 23, 1984) [104 F.T.C. at 816]. We also infer that implied representations and omissions are material when they pertain to the central characteristics of the products or services being marketed, such as their performance, quality, cost, or purpose. *Id.* at 60.

As we noted above, a number of the representations respondents made about the investment value of their land were **[97]** express, and we therefore conclude those representations were material. In addition, respondents' investment representations—both express and implied—addressed the performance, quality, cost, and purpose of the property in question and are therefore material. The information respondents omitted to disclose to correct consumer misimpressions they created about the risks of investment and resale is also material because it relates to the central characteristics of the transaction about which we would expect consumers to be concerned. We therefore conclude that respondents' misrepresentations of the investment value of their land and their failures to disclose the substantial risks of investing in the property were material.

As we described *supra*, respondents' investment representations were inaccurate. The record demonstrates that the land respondents sold is not a good, low-risk investment and does not have the attractive investment characteristics of profitability, fast appreciation, ease of resale, low risk, and safety that respondents represented. The prices respondents charged for their land were far greater than its market value, making losses likely and profits highly unlikely, and there was virtually no resale market for the land. Further, no oil or gas drilling has occurred and no wells have been sunk within miles of the property, and the land is not known to have commercial amounts of oil and gas. Finally, as we have indicated, the construction of a nuclear power plant or guayule processing plant were highly speculative events. **[98]**

Because respondents' investment, oil, and development representations were inaccurate, we conclude that they were likely to mislead consumers. It is axiomatic that inaccurate representations about the investment value of land can mislead consumers. Respondents described the land as a solid, virtually risk-free investment, thus presenting the purchase opportunity as an attractive, money-making proposition with few if any drawbacks. Since in fact it was not, consumers' reasonable expectations about the land's investment value were not met, and they were therefore likely to have been misled. Moreover, the record shows that consumers actually were misled by respondents' misrepresentations. We therefore conclude that respondents' investment representations were deceptive in violation of Section 5.

Respondents' omissions of information as to the riskiness of the land as investment property were likewise deceptive acts or practices, because respondents failed to disclose qualifying information needed to correct consumer misimpressions they created. Respondents did not disclose the uncertainty of the future value of the lots or the probable inability of purchasers to resell the lots at or above their purchase price. Consumers would not reasonably have anticipated these risks because respondents expressly promised otherwise. Disclosure of these risks was material to purchasers both because of the contrary representations made to them and because the information relates directly and significantly to a primary reason for purchasing the land: its purported investment value. We therefore hold that **[99]** respondents engaged in deceptive practices within the meaning of Section 5 by failing to disclose the land's riskiness as an investment.

2. Count II

We also find that respondents represented to consumers that the land they offered for sale was suitable for homesites, farming, ranching, and related uses. Like respondents' investment representations, these representations were made both expressly and impliedly.

Respondents expressly represented that the parcels they sold could be used for homesites and were suitable for elaborate residential uses. Respondents also made express statements that the land could profitably be farmed and would grow sufficient produce for personal consumption, to provide financial independence, and to support at least subsistence level living. Finally, respondents expressly represented that one or two head of cattle for personal consumption could be raised on the land. These representations were made orally and in writing in convincing, graphic terms, and consumers reasonably could have interpreted them as they were made.

In addition, respondents made a number of implied representations. First, respondents described their land in their advertising and promotional brochures as suitable for farming or orchards, as well as for personal gardening, and referred to farming as a major industry in the area. Consumers could reasonably have concluded from these assertions that the farming-related utility of respondents' land made it a good [**100**] investment. Second, prospective buyers could reasonably have interpreted respondents' express representations that their land could be used to raise cattle for personal consumption to represent that their land was consequently a good investment since these ranching claims were made in conjunction with express investment representations. We therefore conclude that respondents impliedly represented that their land was a good investment because of its utility for farming and ranching purposes.

Though respondents made numerous representations about potential uses of the land, they failed to disclose the substantial risks and costs associated with these uses. In the absence of qualifying disclosures, and in light of their affirmative representations, respondents' silence on these points could have caused reasonable consumers to believe that these considerations did not pose substantial impediments to their use of the land. Respondents' failure to provide adequate information to correct these misimpressions therefore constitutes an omission.

The land use representations respondents made were material, as was the information they failed to disclose about impediments to use of the land. As we noted *supra*, a material act or practice is one that is likely to affect a consumer's choice or conduct regarding a product or service. Representations pertaining to the cost or purpose of a product, whether express or implied, and omissions of information needed to correct [101] consumer misimpressions about these matters, are matters of significant concern to consumers and are therefore material.

We have described at length how respondents represented to potential buyers that the parcels they sold could be used: as homesites; as farms capable of supplying sufficient produce to meet personal needs and to sell for at least subsistence level living; and as property capable of supporting one or two head of cattle raised for personal consumption. Similarly, we have detailed the failure of respondents to disclose important information about the costs of utilities and other amenities and about the substantial risks and costs in using the land as represented. Because these representations and omissions pertain directly to the purposes for which respondents' land could be used and to the costs of those uses, we conclude that they were material.

The land use representations respondents made were inaccurate, largely because of the expense of obtaining water, electricity, and other utility services and because of other limitations inherent in the land. For example, though water may be available, it is available only at great cost. The same is true for other utilities needed if the land is to be used in the ways respondents advertised. Other characteristics of the land also make it unsuitable for the advertised uses. Farming designed to sustain even a subsistence level of living is only possible with irrigation and even then is a risky endeavor made even less attractive by the absence of a local market for any product grown. Moreover, the typical acreage sold by respondents [102] cannot independently support livestock, so that ranching is only possible for those buyers who install supplemental feed lots.

Respondents' land use claims and the related omissions of fact were likely to mislead reasonable consumers. This is because respondents' representations described the land in an inaccurate and incomplete fashion that concealed significant costs and limitations on use that consumers who purchased the land would encounter in attempting to act on the basis of the representations that were made. In fact, the land cannot perform as promised and consumers cannot undertake the represented uses without major expenses or limitations. Consumers' reasonable expectations about the land were therefore not fulfilled, and they were likely to have been misled. Similarly, respondents' failure to disclose material information about the costs and limitations of various uses for the land was likely to mislead consumers who had contrary beliefs created by respondents' practices. We therefore find respondents' misrepresentations about potential uses of the land and their failures to disclose material information bearing on those advertised uses to be deceptive acts or practices in violation of Section 5.

B. *Respondents' Liability for Unfair Practices*

Count III of the complaint alleges that respondents committed unfair practices in violation of Section 5 by inducing the purchase of land that had little or no value for the represented uses through deceptive representations, and by receiving and **[103]** retaining the proceeds of those purchases.[81] The Commission has previously set out the elements of unfairness used to determine whether an act or practice is unfair.[82] Those elements are, in brief, substantial injury to consumers that cannot reasonably be avoided and that is not outweighed by any countervailing benefits to consumers or competition.

The first portion of Count III, which challenges respondents' conduct inducing the purchase of land that has little or no value for the represented uses, focuses on the role of deceptive representations in making sales at inflated prices.[83] Misleading representations of this sort can certainly be deceptive, and therefore unlawful. Since deception is a means of harming consumer choice, moreover, such representations are unfair as well. Stated this way, however, this portion of Count III does no more than repeat the essence of Counts I and II, in **[104]** which we have already found the respondents' sales practices to be deceptive and therefore unfair. There is no need to revisit those conclusions.

The second portion of Count III alleges that it is unfair to receive and retain the proceeds of purchases induced by means of deceptive representations. This allegation does state a separately cognizable cause of action that has not already been addressed as a deceptive practice. We conclude that inducing consumers through misrepresentations to make payments on land they have purchased, as respondents did, constitutes an unfair trade practice under the criteria outlined above. Our conclusion that this is so arises principally from the pervasive and continuing exposure of consumers to misrepresentations about the land, which we described in Section II, *supra*. The Commission has reached similar conclusions in other cases where a respondent's receipt and retention of money through misrepresentations and other illegal means were ruled unfair. *See Holiday Magic*,

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[81] Counts I and II of the complaint alleged that respondents' practices were unfair as well as deceptive. Since we have found the practices deceptive, it follows that they were also unfair; the misrepresentations and omissions of fact respondents practiced caused substantial injury to consumers that could not reasonably have been avoided and that was not outweighed by any countervailing benefits.

[82] *See* Letter from Federal Trade Commission to Honorable Wendell H. Ford and Honorable John C. Danforth (December 17, 1980).

[83] The complaint does not charge, and we do not hold, that it is illegal to charge too high a price for a commodity, or that it is unfair for consumers to agree to too bad a bargain. Such a theory probably could not be sustained under the Commission's unfairness standards in the absence of additional factors rendering the transaction unfair.

Inc., 84 F.T.C. 748, 1045–46 (1974); *Universal Credit Acceptance Corp.*, 82 F.T.C. 570, 647–48 (1973), *rev'd in part sub nom. Heater v. FTC*, 503 F.2d 321 (9th Cir. 1974); *Curtis Publishing Co.*, 78 F.T.C. 1472, 1516 (1971) (dictum).[84]

Respondents' practices resulted in substantial monetary injury to consumers, because they induced consumers to continue **[105]** paying substantial amounts for land under their purchase agreements—despite the low value of the properties they had purchased—through a variety of continuing misrepresentations. Thus, those consumers suffered monetary losses they might otherwise have limited by terminating payments, seeking to rescind their contracts, or attempting to resell their land. In short, consumers who purchased land from respondents paid substantial sums of money to respondents but did not receive the benefit of their bargains, either as an investment or as a function of the uses to which the land could be put. Their failure to receive the value or functions they paid for injured them substantially.

Consumers could not reasonably have avoided this injury, because respondents' practices hindered the free exercise of informed consumer decision-making. In particular, respondents' repeated post-purchase misrepresentations about the land inaccurately and incompletely portrayed its value and suitability for various uses. Consumers who continued to make payments on their parcels could not reasonably have avoided the injury they suffered, because respondents' continuing assurances and misrepresentations made it difficult for consumers to learn of the relative worthlessness and unsuitability of their land. Respondents' reliance on their refund policy as a means by which consumers could have avoided injury (RAB 56) is misplaced. Respondents' practices probably induced many consumers to decline to seek refunds and, in any event, the refund policy was quite restrictive. **[106]**

Finally, we find no countervailing benefits to consumers or to competition from respondents' practice of receiving and retaining through misrepresentations payments for land of little or no value. There can be no benefit to society from the dissemination of misrepresentations that induce consumers to continue making payments that they might very well have terminated if they had not been misinformed. *Cf. Virginia Board of Pharmacy v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748, 771–72 (1976); *Sears, Roebuck & Co. v. FTC*, 676 F.2d 385, 399 (9th Cir. 1982). Receiving and retaining money on that basis distorts the free and fully-informed exercise of consumer choice and offers no countervailing benefits to society; it simply enriches wrongdoers.[85]

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[84] Though the unfairness of such conduct is well-established, our ability to order restitution of monies already collected has been constrained by the decision in *Heater v. FTC*, 503 F.2d 321 (9th Cir. 1974), and we decline to order restitution to redress past consumer injury in this case. *See* Section IV, *infra*.

Because respondents' conduct satisfies all three elements of the Commission's unfairness definition, we conclude that respondents' receipt and retention of funds whose payment was induced by post-purchase misrepresentations constitutes an unfair act or practice in violation of Section 5. **[107]**

C. *Respondents' Liability for Agents' Acts*

An important legal issue in this case, treated only briefly by the ALJ, is whether respondents are liable under Section 5 for the actions of their broker, Porter Realty. The evidence indicates overwhelmingly that Porter Realty sales personnel misrepresented various aspects of the properties they sold for respondents during the period of their relationship, particularly the investment value of the land and the extent and significance of nearby oil and gas activity. The ALJ concluded that respondents were not liable for these misrepresentations because "there must come a point where a respondent is permitted to exculpate himself." (ID pp. 113–14) While we agree that that is a correct statement of the law, we disagree that that point was reached here. We hold instead that respondents violated Section 5 through the actions of their agents, Porter Realty and the other brokers who acted with actual and apparent authority on respondents' behalf.

A respondent may be liable for deceptive acts or practices committed by another in at least two circumstances: when the other person has respondent's actual authority to perform the acts, and when the other person performs acts within the scope **[108]** of his or her apparent authority.[86] We discuss each of these theories in turn.[87]

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[85] Respondents argue that no unlawful retention of funds occurred here because the money respondents obtained from consumers was "lawfully expended for reasons other than avoidance of a restitution order," citing *Holiday Magic, Inc.*, 84 F.T.C. 748, 1048 (1974). (RAB 56–57) We believe respondents have misconstrued that opinion as we find nothing in it suggesting that no unfair retention of money occurs so long as deceptively obtained funds are spent. Rather, the Commission simply noted in the discussion of remedial provisions ordered that expenditures of money by respondents made those funds unavailable for return to consumers under a restitution program.

[86] Respondents also may be liable under the "placing in the hands" doctrine for misrepresentations made to prospective purchasers in printed materials Porter Realty received from respondents and supplied to consumers. Under this doctrine, "[o]ne who places in the hands of another a means of consummating a fraud or competing unfairly in violation of the . . . Act is himself guilty of a violation of the Act." *Regina Corp. v. FTC*, 322 F.2d 765, 768 (3d Cir. 1963). *See also FTC v. Winsted Hosiery Co.*, 258 U.S. 483, 494 (1922).

[87] Though respondents analyze the requirements of agency law developed under the common law, we rely instead on Commission case law and precedent. We believe respondents' brokers would be seen to act with actual and apparent authority under common law principles as well, but we need not reach that issue. As the Commission commented in *Atlas Aluminum Co.*:

> Whatever the legal relationship between respondents and their salesmen might have been under the law of contracts or the law of agency, it is well established in trade regulation law that respondents are responsible under the Federal Trade Commission Act for the representations of their sales representatives.

71 F.T.C. 762, 787 (1967). *See also Goodman v. FTC*, 244 F.2d 584, 590 (9th Cir. 1957); *Grolier, Inc.*, 91 F.T.C. 315, 459 (1978) ("The Commission is not bound by the common law rules governing vicarious liability or agency."); *Weavers Guild*, 52 F.T.C. 982, 987, 994 (1956), *aff'd sub nom. Goodman v. FTC, supra.*

1. Actual Authority

That respondents are responsible for acts, including misrepresentations, they have expressly or implicitly authorized others to perform for them can hardly be questioned. *See Restatement (Second) of Agency* Section 257; W. Sell, *Agency* Section 102 (1975). Those authorized to act or who reasonably believe they are authorized to act on behalf of respondents are agents of **[109]** respondents whose every act (within the scope of the agency relationship) is equivalent to an act performed by the respondents.

In this case, respondents gave Porter Realty actual authority to make both oral and written representations with respondents' approval. The Agents Agreement under which Porter Realty represented respondents contained two provisions in this respect: one clause allowing use of advertising, promotional material and sales presentations with respondents' written approval, and a second clause prohibiting representations about the properties except for those authorized by respondents. (CX 37) The record establishes that respondents did authorize Porter Realty to use a variety of promotional materials and to make numerous representations about the land. For example, respondents supplied Porter Realty with brochures, fact sheets, contracts and other sales materials containing statements about the investment potential of the property and the existence of nearby oil exploration and development. Respondents told Porter that representations could be made based on anything in those sales materials.[88] (Porter Tr. 2370) Respondents also authorized Porter Realty to pass on to prospective buyers written materials respondents supplied that were intended to be used as sales tools and that described the property in question, its investment value, and its potential use. (Porter Tr. 2270–77, **[110]** 2285, 2291; Kritzler Tr. 4107) And respondents orally approved materials prepared by Porter Realty for use in marketing.[89]

The parties hotly debate whether Porter Realty's use of the "oil map" was authorized by respondents: Porter says it was, Kritzler says it was not.[90] It is clear respondents were aware of their agents' use of the map over some period of time. (Kritzler Tr. 4124–25) Moreover, respondents maintained a very **[111]** close relationship with Porter Realty, and Kritzler and Porter spoke with each other on the telephone daily to discuss sales and sales strategy. (Porter Tr. 2302) During that time Porter Realty continued to use the oil map, perhaps for as long as one year. It also appears that respondents' own brochures and fact sheets contain references to oil and the oil industry in the area. In light of this evidence, we give little credence to Kritzler's declaration that he did not know of or authorize use of the oil map.

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[88] Porter Realty's employees used these materials as the basis for telephone scripts used in promoting the land to consumers. (Porter Tr. 2294–95)

[89] According to Porter, materials that were not prepared directly by respondents were approved by Kritzler: "Almost every time I used something new, I would send them a copy. I would speak with Kritzler every day about the sales, how to help sales, and I would mention that—I was going to use a new brochure, and he would always say send me a copy." (Porter Tr. 2301) Kritzler testified that he did not approve use of all materials, notably the oil map (Kritzler Tr. 4124–25), while Porter testified that Kritzler approved of the use of nearly all materials including the maps, but said that Kritzler warned against their misuse. (Porter Tr. 2314, 2358) At any rate, it is clear that Porter and Kritzler had a very close working relationship, and were in almost daily contact about sales practices, materials and techniques.

[90] Porter stated that Kritzler had no objections "to using them, no, he didn't." (Porter Tr. 2314) Porter explained on cross-examination by respondents' counsel that Kritzler said "[i]t's okay to use it, but how are you gonna control it, using it is fine but be very careful we want no mention of anything about oil or anything in or near the properties. And he spoke of this continually." (Porter Tr. 2358) Kritzler stated that he first learned that Porter Realty was using the oil map in "late fall of 1977" and that he did not authorize use of the map. (Kritzler Tr. 4124–25) Further,

(footnote cont'd)

Even if respondents did not explicitly authorize use of the oil map, however, respondents' actions constituted implicit authorization. As we noted in *Horizon Corp.* in our discussion of short term profitability claims made by Horizon's agents:

> It is difficult to believe that Horizon management did not searchingly inquire as to the marketability of its product and the manner in which its agents represented that product. . . . However, even if Horizon management chose to remain ignorant of the time frame representations made by its sales force, its ignorance constitutes a failure to exercise reasonable diligence in controlling sales practices in the field, and does not serve as a defense to Section 5 liability. . . . Therefore, we conclude that Horizon allowed its agents to make false and misleading statements in marketing its properties.

97 F.T.C. 464, 815 (1981). Respondents here likewise cannot, through a seemingly conscious refusal to acknowledge what they must have known, shield themselves from responsibility for the actions of brokers who sold 80 percent of their land. The record shows, moreover, that respondents did authorize Porter Realty to make investment and oil-related representations to consumers **[112]** orally and in written materials prepared from respondents' marketing materials, because respondents permitted their brokers to repeat whatever claims appeared in their own promotional materials which, as we noted above, included oil-related statements. Respondents therefore are liable for the deceptive practices Porter Realty and its sales representatives committed in keeping with respondents' authorization.

2. Apparent Authority

Respondents also may violate Section 5 when actions of agents vested with apparent authority deceive the public for the benefit of the respondent. *See Beneficial Corp.*, 86 F.T.C. 119, 161 (1975), *aff'd*, 524 F.2d 611 (3d Cir. 1976), *cert. denied*, 430 U.S. 983 (1977); *Horizon*

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he testified that on learning of its use he "[c]alled Porter immediately and told him not to use the map, that it was outside of his jurisdiction to do that." (Kritzler Tr. 4125–26) Nothing in the record suggests that use of the oil map was approved in writing as the contract between Porter Realty and respondents seems to require. However it is clear from the parties' failure to reexecute an agreement during the later years of Porter Realty's engagement that the written terms of their contract were not essential to the relationship. In any event, Porter Realty's failure to secure written approval for its activities does not prevent us from finding as a factual matter that respondents did indeed authorize certain representations.

Corp., 97 F.T.C. 464, 860 (1981). Here the question focuses on the consumer and whether the consumer believes the agent has been empowered by the principal to make the representations in question. Indeed, even where a principal has made efforts to prevent misrepresentations or to limit actions by agents the principal may be held liable under Section 5 if the agents, acting within the scope of their apparent authority as manifested to the consumer, ignored the principal's directives and violated the law. *See Standard Distributors, Inc. v. FTC*, 211 F.2d 7, 13 (2d Cir. 1954). The apparent authority of an agent must be established through proof of the principal's conduct or representations, and the determination that an agent is apparently authorized to bind the principal is a question of fact. W. Seavey, *Law of Agency* Section 16B (1964). These principles have been enunciated in a number of Commission cases. **[113]**

Standard Distributors, Inc. v. FTC, supra, involved a respondent's marketing of encyclopedias through door-to-door sales representatives. Misrepresentations by the sales personnel were in direct violation of the corporation's instructions, but the court upheld the Commission's finding of liability:

> [The salesmen] were nevertheless the authorized agents of the corporate petitioners . . . to sell the books. The misrepresentations they made were at least within the apparent scope of their authority and part of the inducement by which were made sales that inured to the benefit of the corporate petitioner. Unsuccessful efforts by the principal to prevent such misrepresentations by agents will not put the principal beyond the reach of the Federal Trade Commission Act.

211 F.2d at 13. *See also United States v. Johnson*, 541 F.2d 710, 712 (8th Cir. 1976), *cert. denied*, 429 U.S. 1093 (1976) (principal can be held liable for actions of agents acting within scope of apparent authority even if principal attempts to limit agents' actions).

Another case, *Universe Chemicals, Inc.*, 77 F.T.C. 598 (1970), involved an attempt by a principal to shield itself from responsibility for acts of sales personnel by calling them "independent contractors". The ALJ determined that respondents "clothed these salesmen with apparent authority to act for them and ratified the transactions these salesmen initiated. Thus, they are responsible for the representations such salesmen made, even though such salesmen were expressly forbidden to make them." *Id.* at 629. The argument that respondents may avoid liability because they do not actually direct or control their agents' actions is also unavailing: **[114]**

> In claiming that their inability to direct or control the activities of their representatives insulated them from their salesmen's misrepresentations, respondents have apparently misconstrued the applicable legal test, under which, as the examiner correctly found,

> a seller is held liable for deceptive acts in violation of Section 5 of the Federal Trade Commission Act made by individuals whom the seller has invested with apparent authority to act on its behalf and that it is immaterial that respondents have not directed or controlled these persons.

Inter-State Builders, Inc., 72 F.T.C. 370, 402 (1967).

The Commission has not adopted a theory of *per se* or strict vicarious liability for the actions of a business associate in all cases. *See National Housewares, Inc.*, 90 F.T.C. 512, 588 (1977). In cases of apparent agency, however, a principal's liability follows automatically from the finding that an agent appeared to consumers to be authorized by the principal to act on the principal's behalf.[91] The Commission does not limit application of the theory to those instances where respondents have acted in bad faith, without due care, or negligently. Indeed, respondents may be liable for acts they did not authorize **[115]** that occurred without their knowledge and in spite of diligent preventative efforts. The rationale for this seemingly harsh standard was provided by Judge Learned Hand:[92]

> Since the principal has selected the agent to act in a venture in which the principal is interested, it is fair, as between him and a third person, to impose upon him the risk that the agent may exceed his instructions.

Standard Distributors, Inc. v. FTC, supra, 211 F.2d at 15. *See also Royal Globe Ins. Co. v. Bar Consultants, Inc.*, 577 S.W.2d 688, 694 (Tex. 1979) ("lack of authority is not a defense if the agent is acting within the apparent scope of his authority, and not even instructions not to mislead nor diligence in preventing the misrepresentations will exculpate the corporate principal").

Whether an agent has apparent authority to act must be determined by examining manifestations made by the principal to the consumer that the agent is so authorized. In *Atlas Aluminum Co.*, the apparent authority of agents was established by, among other things, their use of contract forms that were imprinted with respondents' name and address and, most importantly, the fact that the: **[116]**

> salesmen did not purchase respondents' products for resale. They sold respondents'

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[91] When considering the possible liability of a principal based on the apparent authority the principal has given to an agent, whether challenged representations or misrepresentations were actually authorized or forbidden is irrelevant. W. Sell, *Agency* Section 108 (1975). Authorization must be considered when determining the *actual* authority of an agent, but *apparent* authority is based on the manifestations of authority by the principal to a third person. Therefore instructions that prohibit the representation, of which the third person does not have notice, do not relieve the principal of liability for the apparent agent's misrepresentations. *Id.*

[92] Judge Hand's formulation of the rationale for holding principals liable for the acts of their agents within the scope of their actual or apparent authority is neither a recent nor a novel approach:

> [T]he merchant [is] answerable for the deceit of his factor, . . .; for it is more reason, that he, that puts a trust and confidence in the deceiver, should be a loser, than a stranger.

Hern v. Nichols, 1 Salk. 289, 90 Eng. Rep. 1154 (1709), *quoted in* J. Hynes, *Agency and Partnership* 167 (1974).

> products on behalf of respondents and thus were employees and agents of respondents and not independent contractors and dealers. Whatever limitations there might have been on the actual authority of the salesmen as agents of respondents (and this was not developed), the fact is that they were acting for and on behalf of respondents and were clothed with at least the apparent authority to make representations and otherwise act in the name of respondents.

71 F.T.C. 762, 787 (1967). In *Wilmington Chemical Corp.*, 69 F.T.C. 828 (1966), principals were found liable for the acts of the "independent contractors" in part because the contractors were provided by the principals with a "sales kit" that contained "advertising literature, samples, and other sales aids." *Id.* at 925.

In *Inter-State Builders*, the Commission found "actual or apparent authority to speak and act for or on behalf" of the principal based on (1) respondents' furnishing the "independent contractors" or "brokers" with printed contract forms bearing the name of the principal; (2) other printed materials with the principal's name, including credit applications; (3) the principal's giving the "brokers" "specific authority to negotiate the terms of and indeed execute the contracts;" and (4) the use of the principals' offices by one of the "independent brokers." 72 F.T.C. at 403. As the Commission noted, "[t]he only conclusion which could be reached by a customer is that he is dealing solely with [the principal] and that the salesman who signs the contract on [the principal's] behalf is its authorized representative." *Id.* at 403–04. The Commission quoted with **[117]** approval the court's assertion in *International Art Co. v. FTC* that "[w]e know of no theory of law by which the company could hold out to the public these salesmen as its representatives, reap the fruits from their acts and doings without incurring such liabilities as attached thereto." 109 F.2d 393, 396 (7th Cir. 1940).

That respondents clothed Porter Realty and their other brokers with apparent authority to make investment and other representations about the land being marketed to consumers is evident. The written materials that the brokers distributed to potential buyers, including brochures, "fact sheets," and purchase agreements, were provided to them by respondents. These materials all had respondents' names, rather than the brokers' names, printed on them. (CXs 74–78) The purchase agreements used to consummate sales stated plainly that the "seller" was SWS, GVA, or GVA II, not the broker who arranged the transaction. (CXs 175H-I, CXs 74–78) Further, the cover letter sent by Porter Realty with the written materials instructed buyers to send a down payment for the property to the appropriate respondent by a check made out to the respondent. (CXs 126, 175E) These manifestations indicated to consumers that the principals in this transaction were not Porter Realty and its representatives, but were the respondents on whose behalf Porter Realty and the other brokers acted.

The substance of the arrangement between respondents and the brokers confirms this implication. Though respondents describe Porter Realty and the other brokers who marketed the land as **[118]** "independent sales brokers" they were not in fact independent sellers of the land. The brokers sold land on behalf of respondents and received a 30 percent commission. (CX 37A; Porter Tr. 2258) *See Atlas Aluminum Co.*, 71 F.T.C. 762, 787 (1967). They did not purchase the land from respondents in order to resell it to consumers for a profit. The materials used by the brokers, described above, reflect this arrangement, so that in both the reality and the appearance of a consumer's purchase transaction the broker represented and acted on behalf of respondents. Statements made by brokers in the course of marketing the land were therefore made within the scope of the brokers' apparent authority, and respondents are accordingly liable for those that were deceptive.

Respondents contend that their liability for actions by "independent" brokers depends on a factual showing that has not been made in this case. Specifically, respondents argue that clauses in the GVA and GVA II fact sheets and sales agreements limited Porter Realty's apparent authority by informing consumers that Porter Realty was unauthorized to make certain representations.[93] Because these disclosures warned consumers how far Porter Realty's authority extended, respondents argue, representations beyond that point, including representations **[119]** about the land's investment value and potential for oil, could not have the appearance of being authorized. We consider first the fact sheet disclosures and then the contract provisions.

The clause in the GVA and GVA II fact sheet reads:

> It is in the interest of the buyer to inspect and read all contract documents before signing to purchase. The property owners fact sheet is given for the purpose of preventing misunderstanding, misrepresentation, fraud, or deceit.
>
> The developer does not authorize anyone to make or cause to be made to any prospective purchaser any representation contrary to the foregoing or any representation which differs from the statements in this fact sheet or the purchase agreement. If any such representation is made, please notify this office at Green Valley Acres, Inc.

(CX 83) The operative phrases in this "limitation" are "contrary to the foregoing" and "which differs from" the fact sheet or purchase agreement. It is not entirely clear what respondents meant by "the foregoing," since these are the first two paragraphs in the fact sheet.

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[93] The SWS fact sheets do not contain clauses purporting to inform consumers of the limits of Porter Realty's authorized representations, though Porter Realty sold SWS properties. (CXs 81, 82)

We assume that "the foregoing" refers to the "contract documents," meaning again the fact sheet and the purchase agreement.

We find this clause, vague and general in its phrasing, insufficient to alter the appearance of authority otherwise created in Porter Realty and the other brokers. Moreover, even if the purported limitation were stated more precisely and communicated more efficiently, it would not in this instance serve to warn consumers that investment and oil representations were unauthorized and should not be relied on. This is because the fact sheet and contract referred to in the limiting clause **[120]** are largely silent on these critical points; they contain no information on the investment potential of the land or the presence there of oil and gas. Yet the fact sheets do mention oil by noting that it is a "Major Industry," presumably of the area if not of the specific GVA or GVA II properties. (CX 84D, 85D) Investment and oil representations made orally by Porter Realty or the other brokers would therefore not be inconsistent with or contrary to the information in the fact sheet. Those consumers who understood the warning and attempted to apply it to see which oral claims should be disregarded would not, under the circumstances, have identified investment and oil claims.

The provisions in the sales contracts respondents point to as limiting the apparent authority of the brokers are not in fact disclosures of the limitations on their agents' apparent authority but are simple integration clauses. The GVA and GVA II contracts both provide that "[t]here is no understanding or agreement between the parties except as expressly set forth herein, and this Agreement may not be amended except in writing and with the consent of the Seller." (CXs 74-76) Like the fact sheet "warnings," this contractual clause does not change the appearance that Porter Realty and the other brokers had authority to make investment and oil representations and does not have the **[121]** effect of warning consumers not to rely on brokers' representations about the value of the land and the significance of oil-related activities in the area.[94]

Respondents' remaining arguments—that no liability exists for their agents' acts because respondents did not retain the illegal fruits of their agents' misrepresentations and because they did not know of or acquiesce in their agents' misconduct—are patently without merit. The refund and surveillance programs respondents ran had at most a minimal effect in correcting, after the fact, injury suffered by some purchasers. The programs did not even approach the point of causing respondents to disgorge all illegal fruits of their agents' conduct. And the record is replete with evidence that respondents acquiesced in and even approved numerous representations made by their agents that we have found deceptive. Accordingly, we conclude that respondents violated Section 5 through the misrepresentations committed by agents whom they vested with actual and apparent authority. **[122]**

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[94] The limited capacity of these clauses to warn consumers about unauthorized representations was further diminished by the timing of their delivery to consumers; the clauses appear in respondents' sales contracts, which were mailed to potential buyers *after* investment and oil representations were made to them by the brokers.

IV. ORDER

Our findings as to respondents' violations of Section 5 of the FTC Act lead us to conclude that an order must be entered prohibiting respondents from engaging in the same or similar conduct in the future. We have decided to issue the attached Order after considering the record in this case and the arguments made by counsel. We are not persuaded, as respondents urge, that no order is necessary and that the individual respondents should be excluded from any order. Nor are we persuaded that the order sought by complaint counsel should be adopted in the form proposed. Instead, we enter an Order against the corporate and individual respondents in this proceeding that varies substantially from that offered by complaint counsel, but that is broad enough to protect the public against the unfair and deceptive acts and practices identified in this opinion without imposing undue burden. *See Bristol-Myers Co. v. FTC*, 738 F.2d 554, 560–62 (2d Cir. 1984).

A. *Respondents' Arguments*

Respondents' principal objections to entry of an order in this case are that it is unnecessary for a variety of reasons and that individual liability has not been established. Respondents argue that no order is needed because they terminated their relations with their brokers years ago and ceased all sales by early 1978; because they cannot resume any deceptive practices due to the restrictions of the Interstate Land Sales Full Disclosure Act [ILSFDA], 15 U.S.C. 1700–1720 (1982); because the state of Texas has obtained an Assurance of Voluntary **[123]** Compliance [AVC] with respondents; and because the individual respondents acted in good faith. We address these arguments below.

1. Need for Entry of an Order

First, respondents' apparent discontinuance of practices violating Section 5 does not, as a practical matter, provide any assurance that such practices will not be reinstated in the same or similar form in the future so that no order is required. While respondents terminated their relationships with their brokers and may have stopped sales of their land,[95] nothing now prohibits them from resuming their marketing activities, hiring new brokers, or starting again to engage in the same conduct practiced in the past by the brokers and by respondents through their sales representatives. Entry of a formal order guards against the resumption of these practices. Moreover, even if respondents have terminated sales of land, they are still collecting payments on prior sales. (Gross Tr. 297) We found respondents' practice of inducing continued payments on purchases through misrepresentations about the land to be unfair, so that an order provision barring that practice is warranted whether or not new sales are continuing.

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[95] Some question remains as to whether and when respondents stopped selling land. *See* note 5, *supra*.

With respect to respondents' ILSFDA argument, we note that respondents' duties under that statute are not coextensive with its obligations under the FTC Act. *Cf. Horizon Corp.*, 97 F.T.C. 464, 861–62 (1981). There are, moreover, a number of exemptions **[124]** from coverage under the ILSFDA of which respondents could avail themselves with a few changes in their operation.[96] Respondents' repeated transgressions of Section 5 also indicate a willingness to violate federal law that we have no reason to believe would not be repeated with respect to the requirements of the ILSFDA. For these reasons, the ILSFDA does not provide sufficient protection against respondents' use of deceptive land sales practices, and a Commission order is needed to ensure that consumers are amply protected.

With respect to the AVC respondents entered into with the Texas Attorney General in December 1978 (CX 207), we find it to be much weaker and more limited than the Order we deem necessary here. The AVC does not cover respondents Gross and Kritzler as individuals, nor does it apply to SWS. It is also narrower than the order we enter since it limits its reach to the specific practices listed. (CX 207B-C) Finally, the AVC is a voluntary device, not enforced by the Commission, and allowing for only limited enforcement by the state of Texas and perhaps only within **[125]** the confines of that state. A legally enforceable cease and desist order with nationwide reach has much stronger power to regulate respondents' practices than does this voluntary AVC device.

Finally, we reject respondents' argument that no order is needed because the individual respondents acted in good faith. We find sufficient evidence of the individual respondents' personal participation and acquiescence in the activities constituting unfair and deceptive practices that their inadequate attempts to limit, after the fact, the effects of these practices on some consumers do not, taken together, establish their good faith. In any event, we do not accept the proposition that Commission orders need not be imposed on those who violate the law unintentionally or in good faith. *See Chrysler Corp. v. FTC*, 561 F.2d 357, 363 & n.5 (D.C. Cir. 1977) ("an advertiser's good faith does not immunize it from responsibility for its misrepresentations"); *Feil v. FTC*, 285 F.2d 879, 896 (9th Cir. 1960) (existence of good or bad faith not material); *AMREP Corp.*, 102 F.T.C. 1362, 1632 n. 25 (1983), *petition for review filed*, No. 84–1434 (10th Cir., April 2, 1984).

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[96] Before 1978 the ILSFDA did not apply to sales in developments in which the smallest lot was five acres or more. 15 U.S.C. 1702(a)(2) (1976). Respondents were apparently exempt from the ILSFDA under this provision. The minimum acreage exemption was raised to 20 acres in 1978. 15 U.S.C. 1702(b)(4) (1982), so that under their current sales structure respondents appear to be covered by the ILSFDA. However, respondents could take advantage of the exemptions in the ILSFDA by simply increasing the sizes of parcels offered for sale to 20 acres or more, moving their activities outside of the prophylactic provisions of the ILSFDA. So long as an increase in lot size is effected for reasons other than to avoid ILSFDA, the law exempts such sales from the required registration and disclosure obligations. 15 U.S.C. 1702(b)(4) (1982).

Besides the factual shortcomings in respondents' opposition to the Commission's entry of an order, there are legal principles that sustain our rejection of these arguments as well. First, it is clear that a respondent's discontinuance of violative practices and its termination of agents who violated the law does not relieve it of liability for those past actions. *See Horizon Corp.*, 97 F.T.C. 464, 860 (1981); *Standard Distributors, Inc. v.* **[126]** *FTC*, 211 F.2d 7, 13 (2d Cir. 1954). This is especially true where, as here, the Commission may seek consumer redress for respondents' actions in accordance with the provisions of Section 19(b) of the FTC Act. Because a cease and desist order under Section 5 is a statutory prerequisite for action under Section 19, entry of an order is necessary for these reasons as well.

Commission law also holds that voluntary discontinuance of practices by respondents—particularly when that occurs only in the face of an investigation or lawsuit—does not exonerate respondents or render the proceeding moot. *See Fedders Corp. v. FTC*, 529 F.2d 1398 (2d Cir.), *cert. denied*, 429 U.S. 818 (1976); *Montgomery Ward & Co. v. FTC*, 379 F.2d 666 (7th Cir. 1967); *Carter Products, Inc. v. FTC*, 323 F.2d 523 (5th Cir. 1963). The District of Columbia Circuit noted, "[a]ppraisal of the danger that deception may recur if not forbidden is initially for the Commission. If that danger is sufficient, there is no bar to enforcement merely because the conduct has ceased at least temporarily under the weight of the Commission's hand." *W.M.R. Watch Case Corp. v. FTC*, 343 F.2d 302 (D.C. Cir.), *cert. denied*, 381 U.S. 936 (1965).[97] We believe the danger of respondents' repetition of these practices exists in this case because respondents still own the land free of any significant legal **[127]** barriers or limitations on their resumption of sales and marketing activities. For all of these reasons, we conclude that a cease and desist order is necessary.

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[97] Reliance on abandonment as a defense is particularly inappropriate in this proceeding, where respondents dispute most of the material allegations of the complaint and deny that their practices violated Section 5. This places respondents in the position of arguing that they will not engage in certain practices even though they could do so because they believe the practices are legal. *Cf. C. Howard Hunt Pen Co. v. FTC*, 197 F.2d 273, 281 (3d Cir. 1952).

2. Liability of Individual Respondents

We also hold that the order entered should apply to the individual respondents named in the complaint. A cease and desist order may be entered against individuals who participate in the unlawful practices of a corporation or are otherwise responsible for a firm's commission of deceptive acts. For example, an individual is liable for violations of Section 5 if he or she formulates, controls or directs corporate policy. *See Standard Educators, Inc.* v. *FTC,* 475 F.2d 401, 403 (D.C. Cir.), *cert. denied,* 414 U.S. 828 (1973); *Tractor Training Service* v. *FTC,* 227 F.2d 420, 425 (9th Cir. 1955), *cert. denied,* 350 U.S. 1005 (1956). If the individual knew or approved of the illegal corporate practices or played a significant role in carrying them out, a cease and desist order may be entered against the individual as well as the company. *Pati-Port, Inc.* v. *FTC,* 313 F.2d 103, 105 (4th Cir. 1963); *Gold Bullion International, Ltd.,* 92 F.T.C. 196, 210–11 (1978). Individual liability is also appropriate when the individual is actually and personally responsible for the violation or where the respondent corporation is little more than an embodiment of the individual. *See Coro, Inc.* v. *FTC,* 338 F.2d 149, 154 (1st Cir. 1964), *cert. denied,* 380 U.S. 954 (1965); *Virginia Mortgage Exchange, Inc.,* 87 F.T.C. 182, 203 (1976); *Peacock Buick, Inc.,* 86 F.T.C. 1532, 1565–66 (1975), *aff'd,* 553 F.2d 97 (4th Cir. 1977) (opinion unpublished). **[128]**

There is in this case substantial evidence that respondents Kritzler and Gross formulated, directed and controlled the actions of the corporate respondents and participated personally and directly in the unfair and deceptive practices used so that they satisfy the legal requirements for finding individual liability. In many respects, these individuals *are* the respondent corporations. Respondent Gross and his immediate family own all three corporate respondents and serve as officers and directors of them as well.[98] Respondent Kritzler is the general manager of all three corporations, responsible for day-to-day operations, and also serves as an officer of SWS. Gross and Kritzler both are responsible for making corporate policy and, indeed, only these two among all the members of the corporate respondents' management were involved in setting policy. (ID 8, Gross Tr. 315) None of the corporations' directors or officers, other than Gross and Kritzler, are or have been involved in the everyday operations of SWS, GVA, and GVA II. (Gross Tr. 304)

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[98] *SWS:* The president of SWS in December 1973 was Harold Gross, respondent Sydney Gross' son. Laurie Gross, respondent Sydney Gross' daughter, was secretary-treasurer. (Gross Tr. 301). The directors of SWS in December 1973 were Kritzler, Harold Gross, and Laurie Gross. *GVA:* Sydney Gross is president of GVA, his wife Sara Gross is its vice president, and Harold Gross is secretary-treasurer. The directors of GVA are Harold Gross, Sydney Gross, and Barry Gross, another son of Sydney Gross. *GVA II:* Sidney Gross is president of GVA II, Harold Gross is its secretary-treasurer, and wife Sara Gross is its vice president. The directors of GVA II are Sidney Gross and Harold Gross.

The manner in which Gross and Kritzler exercised their manageri-
and policy-making responsibilities demonstrates the **[129]** extent to
hich they were personally involved in practices violating Section 5.
s the ALJ found, Gross and Kritzler selected the properties pur-
ıased and the prices to be charged. They also decided upon the
omotional materials, commercials and contract forms used. (ID 9)
this respect, they were directly responsible for the preparation of
omotional brochures (CXs 87–89) sent to potential purchasers con-
ining express and implied representations that the properties were
od investments and were suitable for use as homesites, farms, and
nches. Gross and Kritzler also prepared or approved television and
dio advertisements that broadcast deceptive investment and use
presentations. (Kritzler Tr. 575; Gross Tr. 411) The individual re-
ondents approved the use of other deceptive materials, including
e fact sheets that omitted critical information about development
sts, printed materials used by Porter Realty, and Porter Realty's
lephone scripts. (CXs 122–125) Kritzler discussed marketing strate-
es and materials with Porter on a regular basis and was aware that
orter Realty was using the deceptive "oil map" for up to a year but
d not successfully stop its use until the broker's contract was ter-
inated. **[130]**

The personal involvement of the individual respondents and their
ntrol over the marketing program were pervasive. In addition to
recting the market efforts of their brokers and sales representa-
ves, Gross and Kritzler participated actively in the sales operations
d engaged in various communications with prospects and purchas-
s. Both Gross and Kritzler wrote letters to purchasers of the land
ressing its value and repeating the investment theme. (CXs 118, 224,
3, 553, 535) Kritzler was also involved in various discussions with
nsumers who testified as to his oral representations about the land's
lue and likely fast appreciation. (Leuckel Tr. 1840; Robinson Tr.
19; Danskin Tr. 2432)

We can only conclude that the individual respondents had an active
d personal role not simply in managing the corporations but in
signing and carrying out a program of unfair and deceptive prac-
ces to induce consumers to purchase their land. Their involvement
es beyond simple tacit awareness, in their official capacities, of the
fair and deceptive practices employed by their representatives.
stead, Gross and Kritzler were primarily and personally responsi-
e for creating the marketing program used by others and for direct-
g the activities of the corporate respondents and their brokers in
ch a way that these parties, too, violated the law. For all of these
asons, we believe an order must be entered against Gross and Krit-
er as individuals. Failure to do so would significantly diminish the

impact of our ruling and reduce our ability to protect consumers from a possible repetition of these practices. [**131**]

B. *Order Provisions*

The Order issued with this Opinion governs respondents' land sales and promotional activities at SWS, GVA, and GVA II as well as at other similar land sales projects. Part I of the Order limits certain representations respondents may make regarding the value or utility of land they sell by requiring that such representations be nonmisleading and supported by a reasonable basis. Specific misrepresentations are also prohibited. Part II requires respondents to disclose to prospective purchasers material information about the land by providing prospects with presale fact sheets. In Part III, respondents are ordered to place warnings in their advertising and promotional materials and to provide consumers a seven-day right to cancel their contracts. Part IV requires respondents to send notices to customers who purchased land explaining what the land's value and suitability for use are and outlining alternatives available to customers. Part V contains a number of administrative obligations, notably requirements that respondents take a variety of steps to discourage employees and agents from engaging in violative practices, and that they institute a surveillance program to detect such practices. The Order as a whole is designed to allow consumers to consider whether to buy land from respondents under circumstances free of misrepresentations and with full and accurate knowledge of information that is material to a purchase decision. [**132**]

1. Definitions

The Order contains five definitions. The term "Respondents" is defined to mean all of the corporate and individual respondents as well as any one of them acting independently or through some agent or device. Thus each respondent is obliged to conform his or its conduct to the Order provisions and to avoid engaging in violative practices jointly or severally.

The provisions of the Order apply only to respondents' practices in selling land, which is defined as in our decision in *AMREP Corp.*, 102 F.T.C. 1362, 1675 (1983), *petition for review filed*, No. 84–1434 (10th Cir., April 2, 1984), to mean unimproved real property. The practices leading to imposition of an Order here involved sales of unimproved real estate only. It is unlikely that respondents would or could easily transfer their deceptive marketing activities to the sale of new homes or other improved realty. We therefore find it appropriate to limit the Order's reach to the marketing and sale of unimproved land.

We retain the definitions of "purchaser" and "Commission" in a form similar to that which complaint counsel proposed but delete the definition of "subdivision" as unnecessary in view of revisions to the Order that delete use of that term. Finally, a definition of "homesite" is added. The definition is adopted from ILSFDA regulations, 24 C.F.R. 1700.1 et seq. (1983), and is designed to provide consistency between the obligations placed on respondents by this Order and under other federal law. **[133]**

2. Part I - Prohibited Representations

Part I of the Order governs the use of certain representations about the value of property that respondents sold, either as an investment or for particular uses. The Order allows respondents to provide potentially helpful information to consumers about the value of property they sell, so long as it is not presented in a misleading fashion and is supported by a reasonable basis in fact. While the complaint in this case alleged that respondents' claims were false and did not allege that the claims had inadequate substantiation, we believe that barring respondents from making claims about the investment value or potential uses of the property in all circumstances is inappropriate and would not benefit consumers. Instead, as in *AMREP Corp., supra,* 102 F.T.C. at 1676–77, respondents may make truthful and nonmisleading representations under the conditions set out in the order. This provision protects the public interest by limiting respondents from future efforts to use misrepresentations to sell property or to induce payments on accounts outstanding while at the same time assuring that truthful and nondeceptive information, that may be helpful to consumers, is still available to the public. This "fencing in" provision, replacing what would otherwise be a flat ban, is justified as a means of preventing respondents from engaging in similar false and deceptive representations in the future. *See FTC v. Ruberoid Co.,* 343 U.S. 470, 473 (1952); *AMREP Corp., supra,* 102 F.T.C. at 1676. **[134]**

Respondents are enjoined under Part I.A. of the Order from making the enumerated representations unless they are not misleading and they are substantiated. This prohibition extends to use of such representations not only in the marketing and sale of land, but also in efforts to induce customers to continue making payments on land previously purchased. Extension of these provisions to nonsale situations is necessary to prevent respondents from continuing practices we have found to be unfair: inducing payments and retaining money paid by using misrepresentations and deceptive statements and omissions about the land.

The representations covered by these provisions correspond to those identified in this Opinion and include claims about the value, profitability, safety, ease of resale, benefits, and use of land. Rather than prohibiting the precise statements respondents used (which would involve a lengthy list of oral and written claims), we have identified several categories of deceptive representations. Thus the specific deceptive claims respondents used as well as claims "like and related thereto" are prohibited by the Order. *See FTC v. Mandel Bros., Inc.,* 359 U.S. 385, 393 (1959). The Order restricts use of these representations in land sales by respondents at the subject properties and elsewhere. Application of the Order to promotional activities for the sale of any unimproved realty by respondents will guard against future violations of the FTC Act similar to those used at SWS, GVA, and GVA II. **[135]**

These portions of the Order are, we believe, reasonably related to the unlawful practices we have found to exist. *See FTC v. Colgate Palmolive Co.,* 380 U.S. 374 (1965); *Jacob Siegel Co. v. FTC,* 327 U.S. 608 (1946). However, we decline to include in the Order additional provisions sought by complaint counsel regulating respondents' use of claims about the availability and price of land since we do not believe restrictions on such claims are needed here to fence in respondents or to protect the public interest. *See FTC v. National Lead Co.,* 352 U.S. 419 (1957).

The substantiation required before respondents may use the enumerated representations is defined in the Order. The substantiation must consist of "competent and reliable evidence" and must include data demonstrating that typical owners are likely to achieve the results claimed. In addition, where respondents seek to use representations that are predictive in that they claim that certain events or developments are likely to or will occur, respondents must have evidence of the sort that would generally be accepted by qualified experts as providing a reasonable basis for the projection. The approach we follow here parallels the order in *AMREP Corp., supra,* where we distinguished between those claims that are presently verifiable with, for example, historical data about resales of land, and those claims that forecast future developments that can be verified only by relying on experts' views about what existing data tell us about the future. Though we do not include in this Order the detailed requirements for substantiating predictive claims set forth in *AMREP Corp.,* the level of support ultimately required for such **[136]** claims is the same in both cases: respondents may not represent that land has or will have investment value, profitability, benefits, or potential uses without a level of support that satisfies experts in the field of the existence of a reasonable basis for the claim and without data establishing that typical owners can achieve what is claimed. To assist the Commission's assessment of respondents' compliance with these substantiation requirements, we have added a provision, Section I.B., requiring respondents to maintain evidence in support of and relied on as substantiation for such claims.

Part I.C. of the Order limits respondents' use of claims about the immediate suitability of land for various applications. This provision prohibits claims that the land is currently usable as a homesite, farm, or ranch unless the land is in fact immediately usable for such purposes without substantial improvements or developments. The complaint did not allege that respondents misrepresented the time frame in which the land could be used or made suitable for use. Respondents did, however, misrepresent the suitability of the land. They failed to disclose the excessive costs of development and improvement that are a prerequisite to most uses of the land while marketing the land for use as homesites, farms and ranches—pursuits for which improvements must be made—and they depicted these uses verbally and visually in their materials and sales presentations. We believe this provision is therefore warranted **[137]** as a fencing-in measure to complement other restrictions on respondents' ability to misrepresent the suitability and usefulness of land they market.

Part I.D. of the Order prohibits respondents from making a number of misrepresentations. These include misrepresentations of the cost or availability of utilities, the likely development of respondents' land, and the extent and significance of mineral resources. These provisions relate directly to practices we conclude respondents engaged in and they are needed to prevent respondents from continuing to make the sorts of misrepresentations we have identified.[99]

Two additional prohibitions on misrepresentations that complaint counsel seek would have stopped respondents from misrepresenting population, employment and industrial statistics and would have eliminated misrepresentations about the independent authorship or production of articles used by respondents as promotional tools. Respondents misrepresented the value of their land by claiming future commercial and industrial developments, and they also provided consumers with flattering **[138]** materials about their land which appeared to have been produced independently but which may have been subsidized or influenced by respondents. However, we do not find the proposed provisions concerning population, employment and industrial statistics to be reasonably related to the problems they purport to address, problems that are corrected through other provisions included in the order. Nor do we find respondents' use of subsidized articles to be a widespread practice of significant moment. Hence we decline to order these prohibitions.

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[99] Respondents' attacks on these provisions as unsupported by record evidence are unconvincing. Respondents argue with respect to I.D.2. (prohibiting misrepresentations of the purchase, use, or development of the land) that respondents fulfilled all their representations about development of the land by building roads and a golf course. This ignores the more serious claims respondents made about industrial and commercial development of the land (including oil exploration) that would increase its value, and it is to these and any similar claims that this provision is addressed. Respondents challenge Part I.D.3. on the grounds that no misrepresentations of mineral rights were alleged or proved. Defining mineral rights to include oil and gas, as we do, establishes the relevance of this provision.

3. Part II - Fact Sheet

Part II of the Order addresses the omissions of fact respondents allowed in their marketing and sales activities. Respondents are required in Part II.A. to send to actual and prospective purchasers a Fact Sheet for Buyers (Attachment A to the Order).[100] The Fact Sheet warns consumers of the risks and uncertainties of investing in land and informs them that expenditures may be needed to make the land suitable and that these expenditures may be so great as to make use of the land impractical.[101] **[139]**

Two versions of the Fact Sheet must be produced.[102] If respondents provide consumers with a federal property report as required by the Interstate Land Sales Full Disclosure Act and related regulations, 15 U.S.C. 1701 to 1720 (1982); 24 C.F.R. 1700.1 et seq. (1983), the Fact Sheet will be quite curtailed, consisting principally of the warnings and disclosures just described along with an advisement that consumers have the terms or merits of their purchase evaluated by a qualified professional before signing anything.[103] If no federal property reports are provided so that consumers may not be receiving detailed information about the availability and cost of utilities on the land, then this information must appear in the Fact Sheet. In this situation the Fact Sheet must include descriptions of the availability of and estimates of the costs for water, sewage disposal, and electric and telephone service. Disclosures sought **[140]** by complaint counsel as to roads, recreational facilities, a property owners' association, taxes, and lot exchanges are not in our view reasonably necessary to prevent the abuses identified in this proceeding and we decline to include them as fencing-in relief.

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[100] The procedures and conditions under which respondents must distribute the Fact Sheets parallel those in *AMREP Corp.*, 102 F.T.C. 1362 (1983), *petition for review filed*, No. 84-1434 (10th Cir., April 2, 1984), and *Horizon Corp.*, 97 F.T.C. 464 (1981). As a rule, respondents must distribute the Fact Sheets in a way that allows prospective purchasers an ample, uninterrupted, and unhurried opportunity in which to review them.

[101] A number of investment value disclosures and warnings are required throughout the Order, to appear in Fact Sheets, advertising and promotional materials, and Notices to customers. We have revised each of the various disclosure obligations contained in complaint counsel's proposed Order to make them similar in content and form so that consumers will see consistent information and similar warnings in the various materials and presentations they encounter.

[102] Requiring two versions of the Fact Sheet is a variant on our approach in *AMREP Corp.*, 102 F.T.C. 1362, 1679 (1983), *petition for review filed*, No. 84-1434 (10th Cir., April 2, 1984). There we ordered only a single, short notice and declined to order repeated in the Fact Sheet the same disclosures required in the federal property report since we believed consumers might be confused or overwhelmed by such a wealth of information. Here we avoid the potential for duplicative disclosures by eliminating most of them from the Fact Sheet when consumers receive the federal property report, but we retain the disclosures needed to inform consumers fully about the land, utilities, and their cost in circumstances where property reports are not provided as they were not throughout all of respondents' operations at SWS, GVA, and GVA II. This approach also reduces substantially the burden of which respondents complain. (RAB 69-70)

[103] Prospective purchasers are also alerted to the existence of the federal property report and encouraged to read it.

These disclosure obligations are needed to ensure that respondents provide prospective purchasers accurate and complete information about the land they are considering buying so that informed decisions can be made prior to sale. Many of respondents' transactions occurred over the telephone and through the mails, and most buyers lived out-of-state, never visited the land, so had few opportunities to learn the truth about their purchases. These disclosures will provide prospective purchasers with material information they might otherwise not have available so that they can better determine whether purchase is a wise move.[104] In addition, in conjunction with the post-purchase cancellation right ordered in Part III, these disclosures give consumers a basis on which to found decisions to cancel. A cancellation period standing alone is not adequate in this case to protect consumers since it furnishes only the time and opportunity but not the information needed to reconsider a **[141]** purchase decision. Thus the disclosure obligations ordered in Part II supplement the other rights we give consumers under this Order.

Additional provisions are included in Part II to further ensure that consumers receive truthful information about the property in advance of signing a contract. Thus Part II.B. provides that if respondents fail to provide purchasers with a copy of the Fact Sheet as prescribed by Part II.A., such purchasers may rescind their contracts and recover all payments within 30 days of the time they finally do receive the Fact Sheet. In view of the extreme importance to purchasers of the information in the Fact Sheet, we feel obliged to allow purchasers this alternative both to deter respondents from failing to provide the Fact Sheet and to accord a remedy to purchasers who might not have bought had complete information been available to them before purchase. Conditional rights of rescission allowed only in circumstances where respondents have violated this Order do not, in our view, run afoul of the decision in *Heater v. FTC*, 503 F.2d 321 (9th Cir. 1974), prohibiting the award of retrospective relief. *See AMREP Corp.*, 102 F.T.C. 1362, 1684 (1983), *petition for review filed*, No. 84–1434 (10th Cir., April 2, 1984).

Finally, Parts II.C. and II.D. prohibit respondents from misrepresenting information in the Fact Sheet and from making representations that differ materially from the Fact Sheet or from the federal property report required by the ILSFDA, 15 U.S.C. 1701 to 1720

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[104] Respondents are mistaken to the extent they believe no additional information, such as the name and telephone number of the electric company, may be furnished to prospective purchasers. (RAB 69) The Order prohibits respondents from including additional information in the required Fact Sheet but does not prevent them from supplementing this information in their promotional brochures or through other devices, so long as they do not misrepresent the information contained in the Fact Sheet. *See* Order Parts II.A., C., D.

(1982). Respondents argue that there is no [142] allegation or proof that such misrepresentations occurred. Of course, since respondents were not obliged to and did not furnish prospects with a federal property report, they could not have misrepresented its contents. The record establishes, though, that respondents did misrepresent the points that would be made in a federal property report and in their Fact Sheets through inaccurate descriptions of the land's suitability and through deceptive omissions of fact. We therefore believe these provisions are warranted to ensure that respondents do not distort, undercut or misleadingly embellish the required factual disclosures. We also believe that such relief reasonably relates to the omissions and inaccuracies we have found in the information respondents did supply to prospective purchasers.

The comprehensive protections afforded by these and other provisions in Part II allow us to dispense with provisions sought by complaint counsel mandating that the Fact Sheet be attached to respondents' contracts with consumers and incorporated therein.

4. Part III - Disclosures in Promotional Materials and Right of Cancellation

Part III of the Order gives consumers additional warnings and a limited cancellation right. Part III.A. requires respondents to disclose in their advertisements and promotional materials the uncertainty of land as an investment and the importance of discussing any purchase of land with a qualified professional. Because of the limitations of different media, shorter and simpler disclosures are permitted in television and radio advertisements and in magazine and newspaper articles of one-quarter page or less. Since respondents' advertisements and [143] promotional materials were the vehicles through which many deceptive claims were made, we deem it appropriate that they should in the future be accompanied by these brief corrective disclosures.

Contrary to respondents' assertions, we need not find that respondents discouraged consumers from seeking professional advice in order to requiure respondents to disclose that prospective purchasers should do so. This admonishment flows from and is justified by the array of misrepresentations respondents directed at consumers, misrepresentations that might have been corrected had consumers discussed their purchases with a knowledgeable professional. The disclosures required by Part III.A. will supplement those in the Fact Sheet and disseminate the information widely by placing it in respondents' advertising and promotional materials.

Also included in this Part is a mandatory seven-day right of cancellation for consumers similar to that contained in the ILSFDA, 15

U.S.C. 1701 to 1720 (1982) and the Commission's Rule on Door-to-Door Sales, 16 C.F.R. 429 (1984). *See also AMREP Corp.*, 102 F.T.C. 1362, 1680 (1983), *petition for review filed*, No. 84–1434 (10th Cir., April 2, 1984). We have shortened the cancellation period from the ten-day period complaint counsel urged to a seven-day period equivalent to that imposed on many other land sellers under ILSFDA. Reference to the right of cancellation is required by Parts III.B. and III.C. to appear in respondents' contract as well as in a separate form, attached to the Order as Attachment B, two copies of which must be provided [144] to purchasers.[105] Included in the cancellation right is a requirement that customers be left free from additional sales pitches and contacts by respondents during the cancellation period. On those occasions where respondents nevertheless make such a contact, Part III.C. extends the purchaser's right to cancel to 30 days after the date of purchase.[106] If the cancellation notice form is not provided when required, the Order gives purchasers an additional seven days to cancel after receiving a copy of the form.

Part III.D. of the Order contains additional provisions regulating how respondents must honor purchasers' cancellation right. Purchasers may exercise their right to cancel either by [145] sending respondents the cancellation form or providing equivalent notification. Once notified, respondents are allowed 30 days to refund purchasers' money and to cancel and return their contracts. Part III.E. prohibits respondents from infringing on the cancellation right provided under this Order by causing purchasers to waive or limit their rights.

Although the complaint did not allege and the record did not reveal evidence of high pressure sales tactics, we believe a cancellation provision is warranted nonetheless. Respondents' sales program was permeated with deceptive representations and omissions of material facts designed to induce consumers to purchase their land. Providing consumers a seven-day cancellation period will allow them to rescind their contracts and have refunded any money paid should they learn of inaccurracies or omissions in the information they received or should they otherwise determine their purchase was unwise. The record does reflect that many purchasers lived out-of-state and had little independent information about the land they bought, a situation that magnified the effect of respondents' misrepresentations and deceptive omissions. Arming purchasers with full and accurate information under Part II of the Order and providing them with a right to cancel after a period of time allowing for full reflection and consideration of the information they will receive furthers the Commission's objectives here by giving consumers some ability to protect themselves. [**146**]

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[105] Our approach differs from that taken in *AMREP Corp.*, 102 F.T.C. 1362 (1983), *petition for review filed*, No. 84-1434 (10th Cir., April 2, 1984), where the Order required that the right of cancellation be announced in the contract but eliminated a requirement that a cancellation form be provided. That was done in part because AMREP's purchasers were expected to receive a cancellation notice and form with the federal property report. *See id.* at 1681. Since this may not occur with respondents' sales, the requirement that a separate cancellation form be provided is in order. Dividing these obligations between two documents in the contract and refer readers to the separate form, where customers' rights are explained more fully.

[106] These provisions differ somewhat from those ordered in *AMREP Corp.*, *supra*, 102 F.T.C. at 1681, where some contacts with purchasers were allowed and others forbidden and where the forbidden contacts triggered an extension of 45 days in the cancellation right only if consumers notified AMREP within 30 days. Because of the difficulties consumers might have distinguishing between proper and improper communications from respondents, we choose here simply to impose a short but complete moratorium on such contacts. We also provide for a shorter but simpler extension of the cancellation right in situations where contacts are made to avoid the more cumbersome two-part notification process set forth in *AMREP Corp.*

5. Part IV - Notice to Consumers

Respondents must send a separate form of Notice to Customers, in the form set forth as Attachment C to the Order, to consumers who previously purchased from respondents land in SWS, GVA, or GVA II, in accordance with Part IV.A.[107] This Notice provides to purchasers much of the same information about costs and availability of utilities that prospective purchasers will receive in the Fact Sheet or federal property report. It also advises consumers of the low value of their land, its unsuitability for certain uses, and the possibility that resales may be difficult to arrange.

Quite a lot of factual information is included in this Notice, including an assessment (based on evidence in the record) of the land's fair market value in 1980 and estimates of the cost of installing utility services. To ensure that these Notices are factually accurate when they are sent to customers 60 days after the Order becomes final, we have provided respondents with a mechanism to propose appropriate revisions which may be incorporated into the Notice unless the Commission objects. The information respondents must disclose about purchasers' future options is similar to that ordered in *AMREP Corp., supra.*

Part IV.C. of the Order was not requested by complaint counsel but is, we believe, necessary to complete the remedial [**147**] scheme of this section of the Order. That provision bars respondents from recovering from defaulting buyers any amounts remaining due on their contracts after the default. We ruled in *AMREP Corp.* that such a clause was "necessary to prevent AMREP from obtaining future profits by enforcing contracts against defaulting buyers where those buyers entered into them in an atmosphere of fraud and deception." 102 F.T.C. at 1683–84. Here as in *AMREP Corp.* it would be intolerable to force respondents to enlighten consumers about the inaccuracies and omissions in the information they received, and yet to permit respondents to continue reaping the fruits of their deception by allowing them to enforce purchasers' contracts. Similarly, we found respondents' inducement and retention of funds, in payment for land that was misrepresented, to be unfair trade practices, and we cannot permit respondents to continue benefitting from illegality within our power to halt. We therefore hold that respondents must allow purchasers to stem the continuing injury caused by respondents' unfair and deceptive practices. As in *AMREP Corp.*, the right to default without fear that remaining obligations can be enforced extends to all purchasers irrespective of the date they executed their contracts. *AMREP Corp., supra,* 102 F.T.C. at 1685.

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[107] To help ensure these notices reach all intended recipients, respondents must make reasonable efforts to locate purchasers whose notices are undelivered because the addresses are outdated or incorrect. Copies of the Notice must be sent to all purchasers for whom new addresses are discovered after an initial nondelivery.

The requirements of this Part, involving affirmative disclosures to past purchasers, do not as respondents contend exceed the Commission's authority under Section 5. (RAB 70) *See Heater v. FTC,* 503 F.2d 301 (9th Cir. 1974). The court in *Heater* prohibited retroactive remedial action by the Commission but did [**148**] not limit the Commission's right to require affirmative action as a prospective remedy. As the court observed in *Warner-Lambert Co. v. FTC,* 562 F.2d 749 (D.C. Cir. 1977), *cert. denied,* 435 U.S. 950 (1978), the decision in *Heater* does not limit the Commission's ability to order affirmative remedial measures under Section 5, such as corrective advertising, when necessary to "correct misconceptions which *future* consumers may hold." *Id.* at 757 n. 33. *See also Waltham Watch Co. v. FTC,* 318 F.2d 28, 32 (7th Cir.), *cert. denied,* 375 U.S. 944 (1963).

The Commission has required firms to take affirmative action as a prospective remedy in several cases, as respondents concede. (RAB 70–71) Thus the Commission ordered a warning letter sent to past purchasers of respondents' "psychic surgery" as a means of remedying the continuing effects of past deception. *Travel King, Inc.,* 86 F.T.C. 715, 774–75 (1975). The Commission also required affirmative disclosures to previous customers about their rights and possible remedies in a case reversed on procedural grounds. *Ford Motor Co. v. FTC,* 94 F.T.C. 564, 605 (1979), *rev'd on other grounds,* 673 F.2d 1008 (9th Cir. 1981), *cert. denied,* 459 U.S. 999 (1982). And the Commission ordered affirmative disclosures virtually identical to those here in another land sales case. *AMREP Corp., supra,* 102 F.T.C. at 1678–80. *See also Horizon Corp.,* 97 F.T.C. 464 (1981).

The Notices ordered by Part IV.A., like those just described, are needed to remedy respondents' deceptive omission of information. Because this practice has continuing ramifications for consumers, many of whom may still be making [**149**] payments on land purchased under significant misrepresentations, a corrective disclosure measure designed to dispel current and future misconceptions is justified. The Notices required by this Part are also legitimate as a means of remedying respondents' continuing unfair practices of inducing continued payments for land through misrepresentations. This relief is quintessentially prospective in nature. It is directed at future payments respondents may induce or retain and it provides consumers with important corrective information needed to dispel the misimpressions respondents created, misimpressions that will continue until affirmative efforts are made to dispel them. The prohibition against enforcement of defaulting purchasers' contracts is likewise a prospective measure authorized under Section 5. *See AMREP Corp., supra,* 102 F.T.C. at 1683–85. This provision bans the future enforcement of such contracts but does not order refunds or redress past injury resulting from respondents' violations of law. For all of these reasons we believe these order provisions are justified.

6. Part V - Additional Provisions

The provisions of Part V are largely administrative in nature and supply additional assurances that respondents' obligations under the Order will be carried out effectively. Of special importance is the provision in Part V.F. requiring respondents to institute a continuing surveillance program that will lead them to investigate and resolve complaints about sales practices used. Parts V.A., H., I., and J. obligate respondents **[150]** to distribute copies of the Order, to notify the Commission of changes in the corporate respondents, and to file compliance reports.

Complaint counsel originally sought restitution in this Section 5 proceeding but have now withdrawn their pursuit of that remedy in this forum. (CCAB 50 n. 24) If buyers are entitled to restitution or other forms of redress for injury caused by respondents' violations of Section 5, their remedies should be sought in a proceeding under Section 19(b). 15 U.S.C. 57(b) (1982); *see AMREP Corp., supra,* 102 F.T.C. at 1674. When the Commission's order in this matter becomes final the Commission will consider whether to seek redress for the unfair and deceptive acts or practices of respondents in accordance with the provisions of Section 19(b).

We decline to include in the Order other provisions proposed by complaint counsel, including a requirement that respondents maintain a toll-free telephone line for customer inquiries, because we do not believe they are reasonably necessary to remedy the violations of law.

V. CONCLUSION

For all of the reasons set forth above, the Initial Decision of the ALJ is modified as described and the attached Order is entered.

FINAL ORDER

This matter has been heard by the Commission upon the appeal of complaint counsel and upon briefs and oral argument in support of and in opposition to the appeal. The Commission, for reasons stated in the accompanying opinion, has granted a portion of complaint counsel's appeal. Therefore,

It is ordered, That the initial decision of the administrative law judge be adopted as the findings of fact and conclusions of law of the Commission except as modified by the accompanying opinion. Other findings of fact and conclusions of law of the Commission are contained in the accompanying opinion.

It is further ordered, That the following Order to Cease and Desist be entered: [2]

ORDER

As used in this Order, the following definitions shall apply:

(A) *Respondents* means any of the corporate respondents, Southwest Sunsites, Inc., Green Valley Acres, Inc., and Green Valley Acres, Inc. II, their successors and assigns, and their officers, directors, representatives, and employees; any of the individual respondents, Sydney Gross and Edwin Kritzler; and any corporation, subsidiary, division, agent, or other device through which any corporate or individual respondent acts.

(B) *Land, property,* or *lot* means any real property unimproved by a commercial or residential building sold or offered for sale by respondents.

(C) *Purchaser* or *buyer* means any individual who is a potential or actual vendee of the land offered for sale or sold by respondents.

(D) *Commission* means the Federal Trade Commission and/or its duly authorized representatives and employees.

(E) *Homesite* means any lot in which (1) potable water is available at a reasonable cost, (2) the lot is suitable for a septic tank or there is reasonable assurance that the lot can be served by a central sewage system, (3) the lot is legally accessible, and (4) the lot is free from periodic flooding.

I

It is ordered, That respondents Southwest Sunsites, Inc., Green Valley Acres, Inc., and Green Valley Acres, Inc. II, corporations, their successors and assigns, and their officers, representatives, and employees, and Sydney Gross and Edwin Kritzler, individually and as officers or former officers of said corporations, directly or through any corporation, subsidiary, division, agent or other device, in connection with the advertising, marketing, offering for sale, sale, or inducement of payments for land, in or affecting commerce, as commerce is defined in the Federal Trade Commission Act, as amended, shall forthwith cease and desist from:

A. Representing, directly or by implication, through the use of any means, that:

1. The purchase of any land has been, is, or will be a good, profitable, short-term, safe, or sound financial investment;
2. There has been, is, or will be little or no financial risk involved in the purchase of any land; [3]
3. The resale of any land is not or will not be difficult, or such land can be or has been resold within a certain time;
4. The purchase of any land is a way to achieve financial security or self-sufficiency, to deal with inflation, or to make money;
5. The value of, or demand for, any land has increased, is increasing, or will increase;
6. Purchasing any interest in land will result in any economic benefit to the purchaser, including but not limited to a benefit resulting from an increase in the value of the land from its use or development for any purpose, or as a result of mineral rights, exploration, or extraction; the land's profitable resale; the provision of a hedge against inflation; or the receipt of income or reduction of expenses from growing any crop, raising any animal, or any other source;
7. Any land is suitable for use as a homesite, farm, or ranch, for personal or commercial purposes;

unless such representation is not misleading and unless, at the time such representation is made, respondents possess and rely upon competent and reliable evidence which substantiates the representation, including, at a minimum, (a) data sufficient to demonstrate that the typical owner of such land is likely to achieve the results represented, and (b) where the representation predicts or projects future occurrences, evidence that would generally be accepted by the community of experts qualified to make such representations as providing a reasonable basis for the projection.

B. Failing to maintain evidence in support of and upon which respondents rely in making any representation about the value, suitability, or use of land, including evidence substantiating the representations described in Paragraph I.A., such evidence to be retained for three years from the date of respondents' last use of such representation and to be furnished to the Commission upon request.

C. Representing, directly or by implication, through the use of any means, that any land is currently usable as a homesite, farm, or ranch, unless such land is immediately usable for such purpose without any substantial improvement or development by the purchaser.

D. Misrepresenting in any manner:

1. The cost of obtaining or availability of electric power, telephone service, potable water, sewage disposal, or any utility; [4]

2. The past, present, planned, proposed or potential purchase, use, or development of any interest in land by respondents or any other party;

3. The extent, location, value, nature, or significance of any actual or potential mineral right or resource or any activity related thereto.

II

It is further ordered, That respondents, in connection with the advertising, marketing, offering for sale, or sale of land in or affecting commerce, as commerce is defined in the Federal Trade Commission Act, as amended, shall:

A. Prepare a "Fact Sheet for Buyers" containing only such information as is set forth or referred to in Attachment A to this Order (incorporated herein by reference), and distribute to all purchasers a copy of the Fact Sheet in the following manner:

1. If respondents invite the purchaser by mail to attend a meeting sponsored by respondents, respondents shall include the Fact Sheet with the invitation;

2. If respondents arrange to meet with the purchaser in his or her home or other location, respondents shall mail the Fact Sheet to the purchaser, allowing sufficient time for the Fact Sheet to arrive at least two days prior to the meeting;

3. If the initial contact with the purchaser is in person (for example, at a booth located in a public place), respondents shall, after identifying briefly the purpose of the contact, give the Fact Sheet to the purchaser, request that he or she read it, and provide ample uninterrupted time for it to be read completely before continuing with any sales presentation;

4. If the initial contact is by telephone or the sale is to be completed entirely through the mail, the Fact Sheet shall accompany the initial mailing to the purchaser.

B. Honor any purchaser's request to rescind the contract and recover all payments thereunder at the purchaser's option, if respondents fail to distribute a copy of the Fact Sheet to such purchaser as required by Paragraph II.A., provided that the purchaser makes such request within thirty days after receiving a copy of the Fact Sheet.

C. Refrain from misrepresenting any information in the Fact Sheet.

[5]

D. Refrain from making any representation, directly or by implication, through the use of any means, about:

1. The present, planned, proposed, or potential development, improvement, or facilities of the land or of the subdivision or project in which the land is located where such representation differs in any material respect from the information contained in the Fact Sheet or the Property Report required by the Interstate Land Sales Full Disclosure Act and related regulations, 15 U.S.C. 1701 to 1720 (1982); 24 C.F.R. 1700.1 et seq. (1983);

2. The respondents' or purchasers' rights or obligations where such representation differs in any material respect from the parties' rights or obligations as stated in the contract, the Fact Sheet, or the Property Report required by the Interstate Land Sales Full Disclosure Act and related regulations.

III

It is further ordered, That respondents, in connection with the advertising, marketing, offering for sale, or sale of land in or affecting commerce as commerce is defined in the Federal Trade Commission Act, as amended, shall:

A. Disclose clearly and prominently in every written promotional material, magazine or newspaper advertisement greater than one-quarter page, and oral sales presentation the following statements:

1. THE FUTURE VALUE OF LAND IS UNCERTAIN. THESE LOTS ARE NOT BEING SOLD AS A FINANCIAL INVESTMENT. YOU SHOULD NOT COUNT ON YOUR LOT RISING IN VALUE OR YOUR BEING ABLE TO RESELL IT. DISCUSS ANY POSSIBLE PURCHASE WITH A QUALIFIED PROFESSIONAL.

2. THESE LOTS MAY BE SUITABLE FOR USE ONLY WITH SUBSTANTIAL EXPENDITURES FOR THE EXTENSION OF UTILITIES, WATER, AND OTHER NECESSITIES. THESE EXPENDITURES VARY DEPENDING ON THE LOCATION OF THE LOT AND COULD BE SO GREAT AS TO MAKE USE OF THE LAND IMPRACTICAL.

B. Disclose clearly and prominently in every radio advertisement, television advertisement, and magazine or newspaper advertisement of one-quarter page or less the following statement:

REMEMBER—BUYING LAND MAY BE RISKY. CONSULT A QUALIFIED PROFESSIONAL BEFORE BUYING. [6]

C. Include clearly and prominently, immediately preceding the space provided for the purchaser's signature in each contract for the sale of land, the following statement in 12-point boldface type:

SEVEN DAY RIGHT TO CANCEL

YOU HAVE THE RIGHT TO CANCEL YOUR CONTRACT, WITHOUT ANY PENALTY OR OBLIGATION, AT ANY TIME UNTIL MIDNIGHT OF THE SEVENTH DAY AFTER YOU SIGN THIS CONTRACT. SEE THE ATTACHED "RIGHT OF CANCELLATION" FOR AN EXPLANATION OF THIS RIGHT.

IF YOU CHOOSE TO CANCEL WITHIN THIS TIME, ANY PAYMENT YOU MADE UNDER THIS CONTRACT WILL BE REFUNDED AND ANY DOCUMENT YOU SIGNED WILL BE CANCELLED AND RETURNED WITHIN THIRTY DAYS AFTER THE SELLER RECEIVES YOUR CANCELLATION NOTICE.

ATTENTION: ALTHOUGH YOU HAVE SEVEN DAYS IN WHICH TO RECONSIDER YOUR DECISION AND CANCEL THIS CONTRACT WITH FULL REFUND, WE RECOMMEND THAT, *BEFORE SIGNING,* YOU CONSIDER YOUR NEEDS CAREFULLY AND HAVE THIS CONTRACT AND THE ATTACHED NOTICE TO BUYERS REVIEWED BY A QUALIFIED PROFESSIONAL.

D. Furnish each purchaser, at or before the time the purchaser signs a contract for the sale of land, with two copies of a form, containing only such information as is set forth or referred to in Attachment B to this Order (incorporated herein by reference), captioned in 12-point boldface type, "RIGHT OF CANCELLATION," and with all other writing in 10-point boldface type.

Provided, however, That if respondents fail to distribute the "RIGHT OF CANCELLATION" forms as required by this paragraph, the period during which the purchaser may cancel the contract shall be extended until seven days after the purchaser receives said "RIGHT OF CANCELLATION".

Provided further, That during the seven-day cancellation period after a purchaser's signing of a land purchase contract, respondents shall not initiate any contact or communication, personal, telephonic, or otherwise, with such purchaser, but if respondents initiate any such contact, the period during which the purchaser may cancel the contract shall be extended until thirty days after the date of purchase. [7]

E. Honor any signed and timely exercise of a "RIGHT OF CANCELLATION" (or its functional equivalent) by the purchaser, and within thirty days after the receipt of such notice of cancellation, (a) refund all payments made under the contract, and (b) cancel and return any contract or other legal document executed by the purchaser.

F. Refrain from misrepresenting, soliciting, or obtaining any purchaser's assent to or otherwise imposing any condition, waiver, or limitation upon the right of a purchaser to cancel a transaction or receive a refund under any provision of this Order or by any applicable statute or regulation.

IV

It is further ordered, That respondents shall:

A. Within sixty days of the effective date of this Order, prepare a "Notice to Customers" containing only such information as is set forth or referred to in Attachment C to this Order (incorporated herein by reference), and cause a copy of such Notice to be sent by first class mail, postage prepaid and address correction requested, to each purchaser of respondents' land in the subdivisions known as Southwest Sunsites, Green Valley Acres, and Green Valley Acres II, at the last known address contained in respondents' files or requested and received from Porter Realty Inc. or Irvin Porter, for each such purchaser.

Provided, however, That if changes are necessary to render the Notice accurate as of the date of mailing, respondents shall submit such changes to the Commission not less than thirty days prior to the date of mailing. The Commission, within ten days after its receipt of such changes, shall have the right to reject them in whole or in part, and respondents will then mail copies of such Notice with any changes that the Commission did not reject.

Provided further, That whenever a copy of such Notice is returned undelivered, respondents shall, within ten days of the return, make all reasonable efforts, including contacting credit bureaus, telephone and utility companies, county land records, and purchasers' relatives or representatives whose addresses are in respondents' files, to obtain the correct present address of the purchaser whose Notice was not delivered, and respondents shall, within twenty days of obtaining a new address, send a copy of such Notice to the purchaser for whom respondents obtain a new address by these means or otherwise.

B. Maintain, for three years after the effective date of this Order or three years after the last Notice is mailed, whichever occurs last, records adequate to disclose respondents' compliance with Paragraph IV.A., and furnish such records to the Commission upon request. [8]

C. Refrain from seeking to recover, or recovering by any means, from purchasers who were under contract before the date this Order becomes final for the purchase of land at Southwest Sunsites, Green Valley Acres, and Green Valley Acres II, and who have defaulted or who become in default, any sums remaining due on their contracts.

V

It is further ordered, That respondents shall:

A. Forthwith deliver by certified mail or in person, a copy of this Order to all present and future sales representatives and other employees, independent brokers, advertising agencies and others who sell or promote the sale of respondents' land or who otherwise have contact with the public on behalf of respondents in connection with the sale of land.

B. Provide each person described in Paragraph V.A. with a form, to be returned to respondents, clearly stating that person's intention to conform his or her sales practices to the requirements of this Order.

C. Inform each person described in Paragraph V.A. that respondents shall not use the services of any such person, unless such person agrees to and does file notice with respondents that he or she will conform his or her practices to the requirements of this Order.

D. In the event such person will not agree to so file notice with respondents and to conform his or her practices to the requirements of this Order, respondents shall not use the services of such person.

E. Inform the persons described in Paragraph V.A. that respondents are obligated by this Order to discontinue dealing with those persons who engage on their own in the acts or practices prohibited by this Order, or who fail to adhere to the affirmative requirements of this Order.

F. Institute a reasonable program of continuing surveillance adequate to reveal whether the practices of each person described in Paragraph V.A. conform to the requirements of this Order, and promptly investigate and make good faith efforts to resolve any complaints about any such person received by respondents, and maintain records of any such complaint, investigation, and disposition of the complaint for ten years from the date of the complaint, such records to be furnished to the Commission upon request.

G. Discontinue dealing with any person described in Paragraph

V.A. who more than once engages on his or her own in the acts or practices prohibited by this Order. [**9**]

H. Forthwith deliver a copy of this Order to each of respondents' subsidiaries.

I. Notify the Commission at least thirty days prior to any proposed change in the corporate respondents, such as dissolution, assignment, reorganization, or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporation that may affect compliance obligations arising out of this Order.

J. Within sixty days after service upon it of this Order and annually for three years thereafter, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with this Order.

Commissioners Calvani and Azcuenaga did not participate.

ATTACHMENT A

FACT SHEET FOR BUYERS

FACT SHEET CONCERNING: ____________ (insert name of subdivision)
NAMES OF SELLER/AGENT: ____________ (insert name of seller and agent)
EFFECTIVE DATE OF NOTICE: ____________ (insert date of notice)

IMPORTANT

YOU ARE ADVISED THAT THE FUTURE VALUE OF LAND IS UNCERTAIN. THESE LOTS ARE NOT BEING SOLD AS A FINANCIAL INVESTMENT. YOU SHOULD NOT COUNT ON YOUR LOT RISING IN VALUE OR YOUR BEING ABLE TO RESELL IT. IF YOU OFFER YOUR LOT FOR SALE, YOU MAY FACE THE COMPETITION OF THE SELLER'S OWN SALES PROGRAM, WHICH MAY INVOLVE AN EXTENSIVE SALES CAMPAIGN. REAL ESTATE BROKERS ALSO MAY NOT BE INTERESTED IN SELLING YOUR LOT OR LISTING IT FOR SALE.

YOU ARE ALSO ADVISED THAT THESE LOTS MAY BE SUITABLE FOR USE ONLY WITH SUBSTANTIAL EXPENDITURES FOR THE EXTENSION OF UTILITIES, WATER, AND OTHER NECESSITIES. THESE EXPENDITURES VARY DEPENDING ON THE LOCATION OF THE LOT AND COULD BE SO GREAT AS TO MAKE USE OF THE LAND IMPRACTICAL.

AS OF THE DATE OF THIS FACT SHEET, THE SELLER HAS SOLD ______ (insert number) LOTS IN ________ (insert name of subdivision). ________ (insert number) LOTS REMAIN UNSOLD AND AVAILABLE FOR SALE.

(In connection with any land for which federal property reports are *not* provided as required by the Interstate Land Sales Full Disclosure Act and related regulations, 15 U.S.C. §§1701 to 1720 (1982), 24 C.F.R. §§1700.1 et seq. (1983), provide the following information:)

THIS FACT SHEET PROVIDES IMPORTANT INFORMATION ABOUT THE VALUE OF THESE LOTS AND THE AVAILABILITY AND ESTIMATED COSTS TO YOU OF UTILITIES, WATER, AND OTHER NECESSITIES.

WATER

(Provide the following information regarding water service:

(a) the method of water service to be used;

(b) if individual wells are to be used: whether the seller is responsible for installing such wells; whether evidence exists that water can be found under every lot offered for sale; the estimated depth at which water can be found in the applicable area; the estimated cost of drilling a well for household purposes and for agricultural purposes if agricultural use is feasible; and whether and under what conditions a refund or exchange will be offered in the event a productive well cannot be installed;

(c) if water is to be provided by a central system: who is responsible for constructing such a system; the estimated amount of any construction costs or any connection or use fees to be paid by the purchaser, including the estimated cost of installing water mains to either the most remote lot in the subdivision or the lot the prospective purchaser is considering purchasing; the estimated service availability date of the water system; and, if the seller is responsible for constructing the system, whether a separate account or fund has been established to finance such construction and the extent of construction completed as of the date of the Fact Sheet.)

SEWER SERVICE

(Provide the following information about sewer service:

(a) the method of sewage disposal to be used;

(b) if sewage disposal is to be by septic tank or other individual system: whether the seller is responsible for installing the system; the estimated cost of the system; whether a permit is required for such a system; and whether and under what conditions a refund or exchange will be offered if the purchaser is unable to install a septic tank or other on-site sewage system;

(c) if sewage disposal is to be by a central treatment and collection system: who is responsible for constructing such a system; the estimated amount of any construction costs or any connection or use fees to be paid by the purchaser; the estimated service availability date of the system; and, if the seller is responsible for constructing the system, whether a separate account or fund has been established to finance such construction and the extent of construction completed as of the date of the Fact Sheet.)

ELECTRIC SERVICE

(Provide the following information about electric service:

(a) whether primary service lines have been extended in front of, or adjacent to, each lot;

(b) if not, the utility company's policy and charges for extension of primary lines, and the estimated cost for extending primary service to either the most remote lot in the subdivision or the specific lot the prospective purchaser is considering purchasing.)

TELEPHONE SERVICE

(Provide the following information about telephone service:

(a) whether primary service lines have been extended in front of, or adjacent to, each lot;

(b) if not, the utility company's policy and charges for extension of primary lines, and the estimated cost for extending primary service to either the most remote lot in the subdivision or the specific lot the prospective purchaser is considering purchasing.)

IMPORTANT: BEFORE SIGNING ANY DOCUMENT, OBTAIN AND READ THOROUGHLY THE CONTRACT AND THIS FACT SHEET. IT IS DESIRABLE TO

HAVE A QUALIFIED PROFESSIONAL EVALUATE THE TERMS OR MERITS OF THIS PURCHASE *BEFORE* YOU SIGN ANYTHING.

(In connection with any land for which federal property reports *are* provided as required by the Interstate Land Sales Full Disclosure Act and related regulations, 15 U.S.C. §§1701 TO 1720 (1982), 24 C.F.R. §§1700.1 et seq. (1983), provide the following information:)

IMPORTANT: BEFORE SIGNING ANY DOCUMENT, OBTAIN AND READ THOROUGHLY EACH PROPERTY REPORT AND CONTRACT. THE PROPERTY REPORT CONTAINS ADDITIONAL INFORMATION THAT YOU SHOULD KNOW AND UNDERSTAND BEFORE YOU SIGN A CONTRACT TO BUY THIS LAND. IT IS DESIRABLE TO HAVE A QUALIFIED PROFESSIONAL EVALUATE THE TERMS OR MERITS OF THIS PURCHASE *BEFORE* YOU SIGN ANYTHING.

ATTACHMENT B

RIGHT OF CANCELLATION

(insert date purchaser signed the contract)
Date of Transaction

(insert lot identification information)
Lot Identification

YOU HAVE THE RIGHT TO CANCEL YOUR CONTRACT, WITHOUT ANY PENALTY OR OBLIGATION, AT ANY TIME UNTIL MIDNIGHT OF THE SEVENTH DAY AFTER YOU SIGN THE CONTRACT. YOU SHOULD USE THIS TIME TO EXAMINE WITH CARE THIS CONTRACT AND THE FACT SHEET OR PROPERTY REPORT. WE ALSO RECOMMEND THAT YOU HAVE THIS CONTRACT AND OTHER INFORMATION ABOUT THE PROPERTY REVIEWED BY A QUALIFIED PROFESSIONAL.

NO REPRESENTATIVE OF THE SELLER SHOULD CONTACT YOU IN ANY WAY DURING THIS SEVEN DAY PERIOD. IF, HOWEVER, THE SELLER OR ITS REPRESENTATIVE CONTACTS YOU DURING THIS SEVEN-DAY PERIOD, YOU MAY CANCEL THE PURCHASE BY NOTIFYING THE SELLER BY MIDNIGHT OF THE THIRTIETH DAY AFTER THE DATE OF PURCHASE.

IF YOU CANCEL WITHIN THIS TIME, ANY PAYMENTS YOU MADE UNDER THE CONTRACT WILL BE REFUNDED AND ANY DOCUMENT YOU SIGNED WILL BE CANCELLED AND RETURNED WITHIN THIRTY DAYS AFTER THE SELLER RECEIVES YOUR CANCELLATION NOTICE.

TO CANCEL THE TRANSACTION, MAIL OR DELIVER A SIGNED COPY OF THIS CANCELLATION NOTICE, OR ANY OTHER WRITTEN NOTICE OR TELEGRAM STATING YOU ARE EXERCISING YOUR RIGHT TO CANCEL, TO (insert name o seller), AT (insert address of seller's place of business) POSTMARKED (if mailed) OR FILED FOR TRANSMISSION (if telegraphed) NOT LATER THAN MIDNIGHT OF (insert date not earlier than the seventh day following the date the purchaser signed the contract).

I (WE) HEREBY CANCEL THIS TRANSACTION. (EACH BUYER MUST SIGN THIS NOTICE.)

(Date)

(Buyer's signature) (Buyer's signature)

ATTACHMENT C

IMPORTANT NOTICE TO CUSTOMERS OF SOUTHWEST SUNSITES, GREEN VALLEY ACRES, AND GREEN VALLEY ACRES II

This letter is being sent to all customers of Southwest Sunsites, Green Valley Acres, and Green Valley Acres II who purchased land in these subdivisions. It contains information you should know about your lot.

In 1980, the Federal Trade Commission began a lawsuit against Southwest Sunsites, Green Valley Acres, and Green Valley Acres II (respondents). The Commission recently decided that case. In its decision, the Commission concluded that respondents made unfair and deceptive claims about the benefits of purchasing their land as an investment or for use as a homesite, ranch, or farm. This letter is being sent as part of the Order issued when the lawsuit was decided.

Please read this letter, consult with an attorney or other qualified professional, and think about your alternatives carefully. We cannot advise you as to what decision is best for you.

I. *Lot Value and Resale*

The future value of land is uncertain. You should not assume that your lot will rise in value or that you will be able to resell it. In fact, the approximate fair market value of your land was only $70 to $110 per acre in 1980. Most land in the Van Horn area, where your land is located, is normally sold in considerably larger tracts than the lot you bought. You may find it very difficult and prohibitively expensive to farm or ranch on your land because of its relatively small size.

Furthermore, there is no certainty that there is or will be in the near future any significant commercial or industrial activity or developments in the Van Horn area that will cause your land to be more valuable. The presence of large ranches and farms near your property has not affected the value of your lot. Development of the surrounding area you may have heard about (for example, construction of a power plant) has not occurred. There has not been and there presently is no significant oil activity on the land in these subdivisions or in surrounding areas.

You may have difficulty selling your lot or listing it for sale. In fact, real estate agents in the Van Horn area will not list properties in Southwest Sunsites, Green Valley Acres, and Green Valley Acres II. Local banks and savings institutions will not use these properties as collateral on loans.

II. *Use of Lots*

You should also know that these lots may be suitable for use only with substantial expenditures of money for the extension of utilities, water, and other necessities. These expenditures vary depending on the location of the lot and could be so great as to make use of the land impractical.

A. *Water:* The source of domestic water for the property is from individual wells drilled by the owner at his or her expense. While the cost of drilling a well varies depending on the driller and depth of the water table, the cost for a well for household purposes is likely to be between $5,000 and $10,000, and the cost of a well for irrigation can be $10,000 to $20,000. It may be necessary to drill 400 feet or more in order to have sufficient reserves from which to pump.

B. *Sewage Disposal:* Sewage disposal is by use of individual septic tanks which cost approximately $1,000.

C. *Electricity:* Electric power is available from local electric companies, but lines have not been extended to individual lots. According to representatives of the electric company in the area, the current cost of extension lines is 75 cents per foot after the first 1/4 mile, which is free. Some lots are as much as two miles from existing lines. Thus, it may cost you many thousands of dollars to obtain electric service.

D. *Telephone:* Telephone service is available, but lines have not been extended to individual lots. According to representatives of the telephone company in the area, the current line extension charge is 50 cents per foot after the first 1/2 mile, which is free if it is public land or public easement. Some lots are as much as two miles from existing lines. Thus, it may cost you many thousands of dollars to install a telephone.

E. *Golf Course:* The golf course owned by Southwest Sunsites Property Owners Association was never completely built and is not currently being maintained.

F. *Use of Lots:* Very few purchasers live in Southwest Sunsites, Green Valley Acres, and Green Valley Acres II. Most of these live in mobile homes. A few purchasers have gardens. There are no commercial farms or ranches and no commercial development on the lots, except on company-owned sites.

III. *Options Available to Purchasers*

The Federal Trade Commission may decide to bring another lawsuit against respondents to seek refunds or other relief for buyers. It is uncertain whether such an action will begin, when it will end, whether it will be successful, or the effect it will have on any buyer. It may be several years before we know the answers to these questions.

Several options are available to you. You may continue to make payments. You may refuse to make any further payments. The Commission's order prohibits respondents from making you pay any more money but if you stop your payments you may lose your land and all of the money you have paid. You may stop making payments and seek satisfaction against respondents in a private lawsuit. The Commission's Order may be relevant in such a suit. You should consult an attorney or other qualified professional before making your decision.

READEX
FICHE

IN THE MATTER OF

INTERNATIONAL SHOE COMPANY, ET AL.

SET ASIDE ORDER IN REGARD TO ALLEGED VIOLATION OF THE FEDERAL TRADE COMMISSION ACT

Docket 6835. Consent Order, March 6, 1958—Set Aside Order, Jan. 30, 1985

In its *Order Reopening and Setting Aside Order Issued March 6, 1958*, the Commission notes that the public interest warrants granting the request filed by Interco Incorporated (formerly International Shoe Company) to set aside the 1958 consent order which barred the company from engaging in exclusive-dealing arrangements with shoe dealers, and providing loans and special services to those dealers who agreed to handle the firm's products exclusively. The Commission found that the same considerations that prompted its July 16, 1984 determination to set aside the 1966 Order issued against the Brown Shoe Company, Inc., 104 F.T.C. 266, which also involved a perpetual exclusive dealing order, are applicable in present action. Accordingly, this Order reopens the matter and sets aside the consent order issued against International Shoe Company on March 6, 1958 (54 F.T.C. 1120).

ORDER REOPENING AND SETTING ASIDE ORDER ISSUED MARCH 6, 1958

On October 9, 1984, respondent Interco Incorporated (formerly International Shoe Company and hereafter "Interco") filed a Request To Reopen And Set Aside Order" ("Request"), pursuant to Section 5(b) of the Federal Trade Commission Act, 15 U.S.C. 45(b) and Section 2.51 of the Commission's Rules of Practice. The Request asked the Commission to reopen the consent order issued on March 6, 1958 ("the order") and set it aside. Interco's request was on the public record for thirty days and no comments were received.

After reviewing respondent's Request, the Commission has concluded that the public interest warrants reopening and setting aside the order as requested by respondent. The action we take today is consistent with our recent determination in *Brown Shoe Company, Inc.*, Docket No. 7606, July 16, 1984 [104 F.T.C. 266], which also involves a perpetual exclusive dealing order in the shoe industry. The same considerations which prompted our action in *Brown Shoe* are applicable to the present request.

Accordingly, *it is ordered*, that this matter be, and it hereby is, reopened, and that the Commission's order issued on March 6, 1958, shall be of no further force and effect as of the effective date of this order.

IN THE MATTER OF

LURIA BROTHERS AND COMPANY, INC., ET AL

SET ASIDE ORDER IN REGARD TO ALLEGED VIOLATION OF THE FEDERAL TRADE COMMISSION ACT AND SEC. 7 OF THE CLAYTON ACT

Docket 6156. Order, Feb. 13, 1963–Set Aside Order, Feb. 1, 1985

After considering respondent's petition to reopen the matter and set aside the Commission's order of February 13, 1963 (62 F.T.C. 243), together with public comments and other relevant information, the Commission found that the order, which, among other things, barred the firm from entering into exclusive supplier arrangements with steel mills and receiving preferential treatment as a scrap metal supplier, no longer serves the public interest. The Commission held that in view of the present characteristics of the ferrous scrap industry, and respondent's present inability to exclude competitors through the exercise of market power, the order no longer serves any procompetitive purpose and may impede Luria's ability to compete effectively for the business of scrap consumers that desire exclusive supply arrangements. Accordingly, the Order reopens the matter and sets aside the Commission's order of February 13, 1963 as it applies to respondent Luria.

ORDER REOPENING AND SETTING ASIDE THE ORDER ISSUED FEBRUARY 13, 1963

By petition filed on September 19, 1984, Luria Brothers & Company, Inc. (hereafter "Luria") requests that the Commission reopen the proceeding in Docket No. 6156 and set aside the order therein. Upon consideration of Luria's petition, the public comments, and other relevant information, the Commission now finds that the public interest warrants reopening the proceeding and setting aside the order as to Luria.

The record describes an industry in which Luria's use of exclusive arrangements to supply purchased iron and steel scrap to any foreign or domestic scrap consumer, including respondent mills, would have no significant anticompetitive effects. Luria's shares in the national and regional ferrous scrap markets have declined steadily since the Commission issued its complaint in this matter. In contrast to its previous dominance in the export of iron and steel scrap, Luria is now only minimally involved in that aspect of the scrap business. Moreover, concentration in the industry has decreased significantly as new firms have entered the market, thus demonstrating the absence of natural or artificial barriers to entry.

In view of the present characteristics of the ferrous scrap industry, and Luria's inability to exclude competitors through the exercise of market power, the order now serves no procompetitive purpose and may impede Luria's ability to compete effectively for the business of scrap consumers that desire exclusive supply arrangements. As a result, we conclude that the order no longer is in the public interest. However, the Commission will not be precluded from taking enforcement action concerning the practices that are the subject of this order when the Commission has reason to believe they violate the law.

Accordingly,

It is ordered, That this matter be and it hereby is reopened, and that the Commission's February 13, 1963 order be and it hereby is set aside as it applies to respondent Luria.

Commissioner Bailey concurred in the result.

IN THE MATTER OF

AMERICAN MOTORS CORPORATION, ET AL.

SET ASIDE ORDER IN REGARD TO ALLEGED VIOLATION OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3093. Consent Order, July 6, 1982—Set Aside Order, Feb. 14, 1985

This Order reopens the proceeding and grants the petitions of a utility vehicle manufacturer and its subsidiary to set aside the FTC Consent Order issued on July 6, 1982 (100 F.T.C. 229 (1982)), which requires them to attach to each new Jeep CJ a sticker warning that multipurpose vehicles handle differently from ordinary passenger cars and sudden sharp turns or abrupt maneuvers may result in loss of control; and to include additional safety disclosures in Owner's Manuals and Supplements. Petitioners' request that the Order be set aside was based on changes in law and fact and on public interest considerations. The manufacturers asserted that a new regulation promulgated by the National Highway Traffic Safety Administration ("NHTSA"), which became effective on September 1, 1984, covers the same subject matter as FTC's Order and makes the Order unnecessary. Further, while the regulation requires all manufacturers of utility vehicles to place a sticker on such vehicles and to disclose in their operating manuals information "to alert drivers that the particular handling and maneuvering characteristics of utility vehicles require special driving practices when those vehicles are operated on paved roads," respondent is the only manufacturer of such vehicles subject to dual liability. After considering all arguments presented by petitioners, and noting that NHTSA, the federal agency with the specific statutory responsibility to regulate automobile traffic, has in effect a regulation, enforceable by the assessment of penalties, that adequately addresses the problem that led to issuance of the FTC Order, the Commission concluded that petitioners had adequately shown that changed conditions of law and fact and public interest considerations require that the Order be set aside. Accordingly, the Commission ordered the matter reopened and the consent order set aside.

ORDER REOPENING THE PROCEEDING AND SETTING ASIDE CEASE AND DESIST ORDER

On September 13, 1984, American Motors Corporation and its wholly-owned subsidiary, Jeep Corporation, respondents in the captioned matter, filed a petition pursuant to Rule 2.51 of the Commission's Rule of Practice to reopen the proceeding and set aside the Consent Order entered therein.

The Order, which was issued on July 6, 1982, requires, *inter alia*, that respondents affix a sticker to the instrument panel or windshield frame of each new Jeep CJ reading as follows:

> **This multipurpose vehicle handles and maneuvers differently from an ordinary passenger car. As with other vehicles of this type, sudden sharp turns and abrupt maneuvers**

may result in loss of control. Read driving guidelines in Owner's Manual and Supplement.

WEAR SEATBELTS AT ALL TIMES

The Order also requires respondents to disclose in the Owner's Manual for new Jeep CJ's and in an informational Supplement to the Owner's Manual the following:

> Utility vehicles have higher ground clearance and narrower track to make them capable of performing in a wide variety of off-road applications. Specific design characteristics give them a higher center of gravity than ordinary cars. An advantage of the higher ground clearance is a better view of the road allowing you to anticipate problems. They are not designed for cornering at the same speeds as conventional 2WD vehicles any more than low-slung sports cars are designed to perform satisfactorily under off-road conditions. If at all possible, avoid sharp turning maneuvers. As with other vehicles of this type, failure to operate this vehicle correctly may result in loss of control or an accident.

The Order further mandates that respondents include the following statement in the introduction to the Supplement:

> As with other vehicles of this type, failure to operate this vehicle correctly may result in loss of control or an accident. Be sure to read on-pavement and off-road driving guidelines which follow.

Petitioners' requests that the Order be set aside is based on changes in law and fact and on public interest considerations. The petition asserts that a new regulation of the National Highway Traffic Safety Administration ("NHTSA") became effective on September 1, 1984, which covers the same subject matter as the Commission's Order. 49 C.F.R. 575.105, *reprinted* in 49 FR 20016 (1984). NHTSA's regulation requires all manufacturers of utility vehicles to place a sticker on such vehicles and to disclose in their Operating Manuals information "to alert drivers that the particular handling and maneuvering characteristics of utility vehicles require special driving practices when those vehicles are operated on paved roads." While the sticker and the disclosures required by the NHTSA regulation were patterned after those in the Commission's Order against petitioners, the language therein differs substantively from the exact language required by the Commission's Order. Violations of both the NHTSA regulation and the Commission's Order may subject petitioners to civil penalties.

Petitioners argue that the new regulation promulgated and implemented by NHTSA constitutes a change of law. The regulation covers the same subject matter as the Commission's Order, and NHTSA is the federal agency with specific statutory authority to regulate traffic safety. *See* 15 U.S.C. 1381 (1982). "In short," petitioners' assert, "the NHTSA regulation has made the Order unnecessary."

As a changed condition of fact, petitioners argue that the new NHTSA regulation ensures that they will continue to make disclosures concerning the handling of utility vehicles. The regulation applies to all utility vehicles, and AMC is the only manufacturer of such vehicles subject to dual liability. Petitioners are, therefore, injured competitively. Furthermore, they contend that they have been placed in an untenable regulatory dilemma. If they comply with the NHTSA regulation, they are in violation of the Commission's Order, and compliance with the Order constitutes non-compliance with the NHTSA regulation. Penalties are assessable for violations of both the regulation and the Order.

Finally, petitioners contend that the public interest requires that the Order be set aside because inconsistent and overlapping regulatory schemes do not serve the goal of efficient government administration.

Under Section 5(b) of the Federal Trade Commission Act and Rule 2.51 of the Commission's Rules, the Commission must reopen the proceeding and consider altering, modifying or setting aside an Order if a respondent files a request showing that changed conditions of law or fact require the Order to be altered, modified or set aside, in whole or in part, or that the public interest so requires.

The National Highway Traffic Safety Admninistration, the federal agency with the specific statutory responsibility to regulate automobile traffic safety, has in effect a regulation, enforceable by the assessment of penalties, that adequately addresses the problem that led to the issuance of the Commission's Order. Therefore, the Commission has concluded that petitioners have adequately shown that changed conditions of law and fact and public interest considerations require that the Order be set aside.

Accordingly, *it is ordered*, that the proceeding in this matter be reopened and the Order set aside.

IN THE MATTER OF

SENTRONIC CONTROLS CORPORATION, ET AL.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3150. Complaint, Feb. 21, 1985—Decision, Feb. 21, 1985

This Consent Order, among other things, requires three Chicago, Ill. corporations and three individuals engaged in the advertising, sale and distribution of an ultrasonic pest control product called the "Pest Sentry," to cease representing that the Pest Sentry or any other ultrasonic pest control device will eliminate cockroaches, rats, mice, and other such pests from a home or place of business; eliminate them within a specified period of time; prevent them from entering or remaining in an area where the product is being used; and serve as an effective alternative to the use of conventional pest control products. The Order further bars respondents from making any performance or effectiveness claims for ultrasonic pest control devices unless they possess and rely on competent and reliable substantiating evidence when making those claims.

Appearances

For the Commission: *Edwin Dosek.*

For the respondents: *Alvin Becker, Beerman, Swerdlove, Woloshin, Berezky & Berkson,* Chicago, Ill.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Sentronic Controls Corporation, a corporation, International Marketing & Manufacturing, Inc., a corporation, Unigraf, Inc. a corporation, Stanley Stewart and Anne K. Stewart, individually and as officers of said Sentronic Controls Corporation and of International Marketing & Manufacturing, Inc., and Richard Muller, individually and as an officer of said Sentronic Controls Corporation and of Unigraf, Inc., hereinafter sometimes referred to as respondents, have violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Respondents Sentronic Controls Corporation (SCC) and International Marketing & Manufacturing, Inc. (IMM) are Illinois corporations with their offices and principal places of business located at 730 North LaSalle Street, Chicago, Illinois.

Respondent Unigraf, Inc. (Unigraf) is an Illinois corporation with its offices and principal place of business located at 60 West Erie Street, Chicago, Illinois.

Respondent Stanley Stewart is an officer of SCC and an officer of IMM. Respondent Anne K. Stewart is an officer of IMM. Respondent Richard Muller is an officer of SCC, and an officer and director of Unigraf. As such, they formulate, direct and control the policies, acts and practices of said corporations, including the acts and practices hereinafter set forth. Their addresses are the same as those of said corporations.

The aforesaid respondents cooperate and act together in carrying out the acts and practices hereinafter set forth.

PAR. 2. Respondents manufacture, advertise and offer for sale, sell and distribute ultrasonic pest control products under the brand name of Pest Sentry.

PAR. 3. Respondents, at all times mentioned herein, have maintained a substantial course of business, including the acts and practices as hereinafter set forth, which are in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act.

PAR. 4. In the course and conduct of their business, and for the purpose of inducing the purchase of the Pest Sentry ultrasonic pest control product, respondents have disseminated, directly and through their marketers and distributors, various promotional materials, including "suggested advertisements", sales brochures and promotional pamphlets, which contain statements respecting the performance of the Pest Sentry ultrasonic pest control product. Examples of such promotional materials are attached hereto as Exhibits A through C.

PAR. 5. Typical statements in said promotional materials, but not necessarily inclusive thereof, are

> A. NOW—ELIMINATE—FLYING and CRAWLING PESTS - RATS - MICE - ROACHES - MOSQUITOES - FLIES - WATERBUGS ULTRASONICALLY.
>
> B. PEST SENTRY eliminates flying and crawling pests . . . safely, economically . . . in 2–6 weeks. WITHOUT . . . calling in expensive pest control services or spending your valuable time using poisonous powders, messy sprays, dangerous chemicals or unsightly traps.
>
> C. You will notice results in a few days and within 4 to 6 weeks you will be free of the entire list of crawling and flying, pests as long as PEST SENTRY "stands guard".
>
> D. THE PEST SENTRY protects indoor facilities from:

- Rats
- Mice
- Flies
- Roaches
- Mosquitoes
- Waterbugs
- Chipmunks
- Squirrels

and other kinds of crawling and flying pests. Research data available upon request from manufacturer.

E. SAY GOOD-BYE TO ANNOYING PESTS! Let Pest Sentry eliminate roaches, rats, mice, mosquitoes, flies, water bugs, and other crawling and flying pests from your home.

F. NOW . . . YOU CAN PROTECT YOUR HOME AND FAMILY FROM FLYING AND CRAWLING PESTS with an all-new Sound Solution to Pest Control!

G. One Pest Sentry covers a very large area, 1500 – 2000 sq. ft. (16,000 cubic ft. for 8 ft. ceilings). The Pest Sentry sound will penetrate doors, drywall and plastered rooms.

H. PEST SENTRY eliminates setting unreliable traps, using messy and often dangerous chemicals and hard-to-control poisonous sprays.

I. [T]he PEST SENTRY is a professional answer for homes, restaurants, warehouses, schools, farm buildings . . . garages, retail stores, hospitals, nursing homes—any indoor location where flying and crawling pests are a problem.

J. Ultra - Effective Pest Eliminator.

COUNT I

Pest Elimination Claims

Alleging violations of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One, Two, Three, Four and Five are incorporated by reference herein.

PAR. 6. Through the use of the statements referred to in Paragraph Five and others not specifically set forth therein, respondents have represented, and are now representing, directly or by implication, that use of the Pest Sentry:

1. Eliminates rats, mice, cockroaches, and other pests from a purchaser's home or place of business.
2. Eliminates rodent and insect problems from a purchaser's home or place of business within two to six weeks.
3. Prevents rodents and insects from entering or remaining in an area in a purchaser's home or place of business where the Pest Sentry device is in use.

PAR. 7. The representations set forth in Paragraph Six are false because use of the Pest Sentry does not:

1. Eliminate unwanted rats, mice, cockroaches, or other pests from a purchaser's home or place of business.
2. Eliminate rodent and insect problems from a purchaser's home or place of business within two to six weeks.
3. Prevent rodents and insects from entering or remaining in an area in a purchaser's home or place of business in which such product is in use.

Therefore, the representations set forth above constitute deceptive and unfair acts or practices.

COUNT II

Ability To Control Pest Claims

Alleging further violation of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One, Two, Three, Four and Five are incorporated by reference herein.

PAR. 8. Through the use of the statements referred to in Paragraph Five, and others not expressly set out therein, respondents have represented, and are now representing, directly or by implication, that the Pest Sentry:

1. Controls effectively rats and mice in the home or place of business.

2. Controls effectively insects, such as cockroaches, in the home or place of business.

3. Eliminates the need to use, in the home or place of business, alternative rodent or insect control products such as traps, powders, sprays or other chemicals.

PAR. 9. In truth and in fact, contrary to the representations made by respondents set forth in Paragraph Eight, the Pest Sentry:

1. Is ineffective for controlling rodents in the home or place of business. Any reaction by rodents to the Pest Sentry would, at best, only be of short duration. Rodents habituate to ultrasound and will return to their chosen nesting or feeding habitats even in the presence of such ultrasonic products.

2. Is ineffective for controlling insects in the home or place of business.

3. Does not eliminate the need to use alternative pest control products such as chemicals, sprays, powders, or traps in the home or place of business.

Therefore, the representations set forth herein constitute deceptive and unfair acts or practices.

COUNT III

Area Coverage Claims

Alleging further violation of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One, Two, Three, Four and Five are incorporated by reference herein.

PAR. 10. Through the use of the statements referred to in Paragraph Five, and others not expressly set out therein, respondents have represented, and are now representing, directly or by implication, that the Pest Sentry will effectively cover an area of 1500 to 2000 square feet in the home or place of business.

PAR. 11. In truth and in fact, contrary to the representations made by respondents alleged in Paragraph Ten, the Pest Sentry will not effectively cover areas of 1500 to 2000 square feet in the home or place of business because among other reasons, ultrasound:

1. Loses intensity as it travels;
2. Is absorbed by soft objects such as carpeting, curtains and drapes;
3. Is reflected by hard surfaces such as partitions, appliances, furniture, cabinets and shelving creating sound "shadows"; or
4. Is unable to penetrate to places of nesting and feeding that are behind and within recesses of walls, under floors or within cracks or crevices.

Therefore, the representations set forth herein constitute deceptive and unfair acts or practices.

COUNT IV

Reasonable Basis - Substantiation

Alleging further violation of Section 5 of the Federal Trae Commission Act, the allegations of Paragraphs One, Two, Three, Four and Five are incorporated by reference herein.

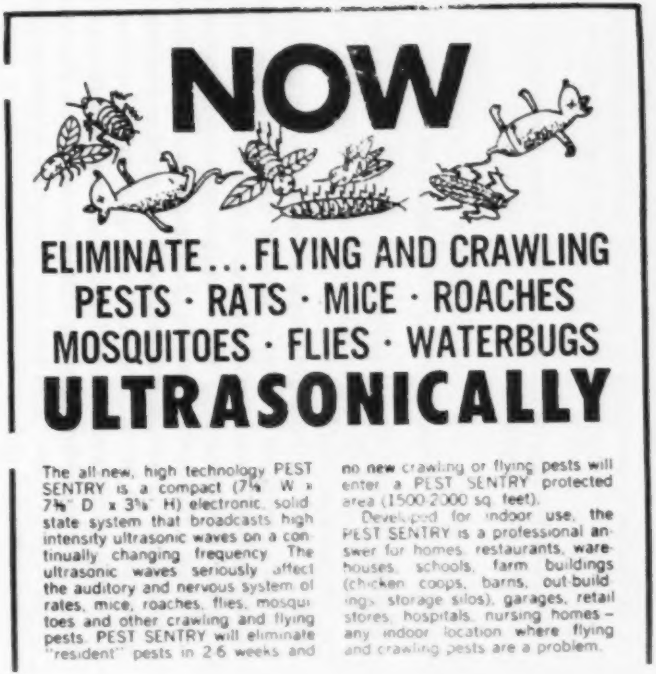
PAR. 12. Through the use of the statements referred to in Paragraph Five, and others not expressly set out therein, respondents have represented and are now representing, directly or by implication, that at the time of making the representations respondents possessed and relied upon a reasonable basis for those representations. In truth and in fact, at such times, respondents did not possess and rely upon a reasonable basis for making such representations because, among other reasons, respondents had not conducted appropriate tests or had improperly applied results of tests done by others. Therefore, said representations constituted and now constitute deceptive and unfair acts or practices.

PAR. 13. The use by respondents of the aforesaid representations, as set forth in Count I–IV, and the placement in the hands of distributors and retailers of promotional materials through which others may have conveyed those representations, have had the capacity and tendency to mislead consumers and to induce the purchase of respondents' ultrasonic pest control products.

PAR. 14. The acts and practices of respondents, as herein alleged, constituted, and now constitute unfair and deceptive acts or practices in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act. The acts and practices of respondents, as herein alleged, are continuing and will continue in the absence of the relief herein requested.

Chairman Miller dissented.

EXHIBIT A-1



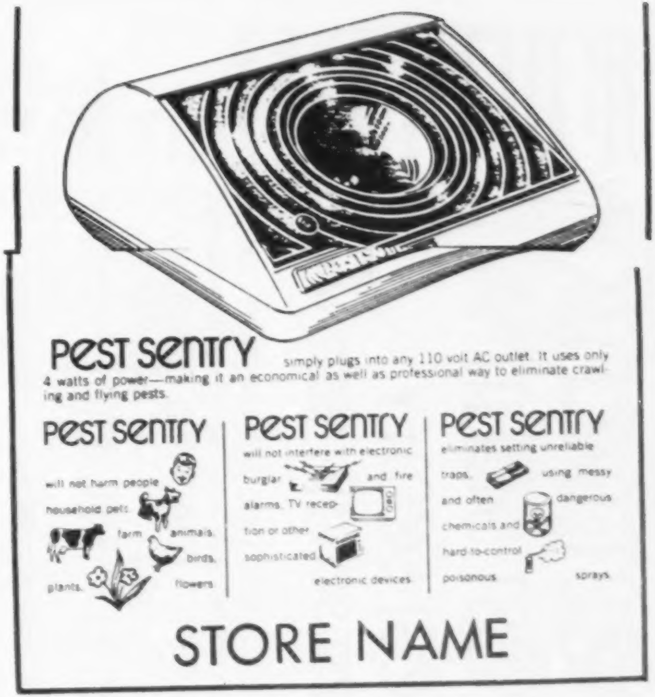
NOW

ELIMINATE...FLYING AND CRAWLING PESTS · RATS · MICE · ROACHES MOSQUITOES · FLIES · WATERBUGS ULTRASONICALLY

The all-new, high technology PEST SENTRY is a compact (7⅛" W x 7⅝" D x 3⅝" H) electronic, solid state system that broadcasts high intensity ultrasonic waves on a continually changing frequency. The ultrasonic waves seriously affect the auditory and nervous system of rates, mice, roaches, flies, mosquitoes and other crawling and flying pests. PEST SENTRY will eliminate "resident" pests in 2-6 weeks and no new crawling or flying pests will enter a PEST SENTRY protected area (1500-2000 sq. feet).

Developed for indoor use, the PEST SENTRY is a professional answer for homes, restaurants, warehouses, schools, farm buildings (chicken coops, barns, out-buildings, storage silos), garages, retail stores, hospitals, nursing homes – any indoor location where flying and crawling pests are a problem.

EXHIBIT A-1 (CONT'D)



PEST SENTRY simply plugs into any 110 volt AC outlet. It uses only 4 watts of power—making it an economical as well as professional way to eliminate crawling and flying pests.

PEST SENTRY will not harm people, household pets, farm animals, birds, plants, flowers.

PEST SENTRY will not interfere with electronic burglar and fire alarms, TV reception or other sophisticated electronic devices.

PEST SENTRY eliminates setting unreliable traps, using messy and often dangerous chemicals and hard-to-control poisonous sprays.

STORE NAME

IMM, INC.
Sentronic Controls Corp.
AD # PS-100
4 Cols. X 16" B&W Ad

EXHIBIT A-2

PEST SENTRY

PEST SENTRY

The professional
ultrasonic sound
wave system

The professional
ultrasonic sound
wave system

PEST SENTRY

The professional
ultrasonic sound
wave system

PEST SENTRY

The professional
ultrasonic sound
wave system

PEST SENTRY

The professional
ultrasonic sound
wave system

ELIMINATES FLYING AND CRAWLING PESTS...SAFELY, ECONOMICALLY

ELIMINATES FLYING AND CRAWLING PESTS...SAFELY, ECONOMICALLY

ELIMINATES FLYING AND CRAWLING
PESTS...SAFELY, ECONOMICALLY

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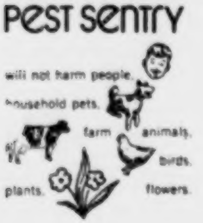
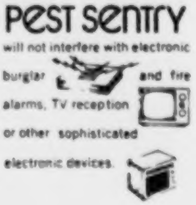
PESTS...SAFELY, ECONOMICALLY



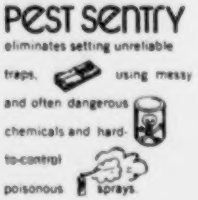
PEST SENTRY

will not harm people, household pets, farm animals, birds, plants, flowers.



PEST SENTRY

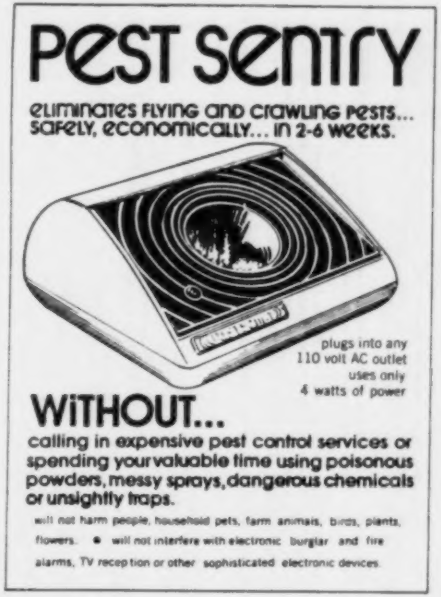
will not interfere with electronic burglar and fire alarms, TV reception or other sophisticated electronic devices.



PEST SENTRY

eliminates setting unreliable traps, using messy and often dangerous chemicals and hard-to-control poisonous sprays.

EXHIBIT A-3



PEST SENTRY

ELIMINATES FLYING AND CRAWLING PESTS...
SAFELY, ECONOMICALLY... IN 2-6 WEEKS.

plugs into any
110 volt AC outlet
uses only
4 watts of power

WiTHOUT...

calling in expensive pest control services or spending your valuable time using poisonous powders, messy sprays, dangerous chemicals or unsightly traps.

will not harm people, household pets, farm animals, birds, plants, flowers. • will not interfere with electronic burglar and fire alarms, TV reception or other sophisticated electronic devices.

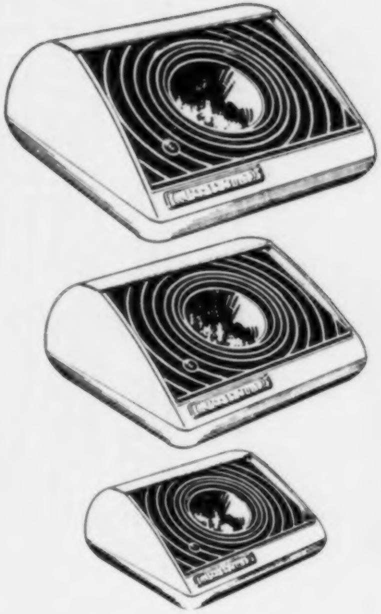
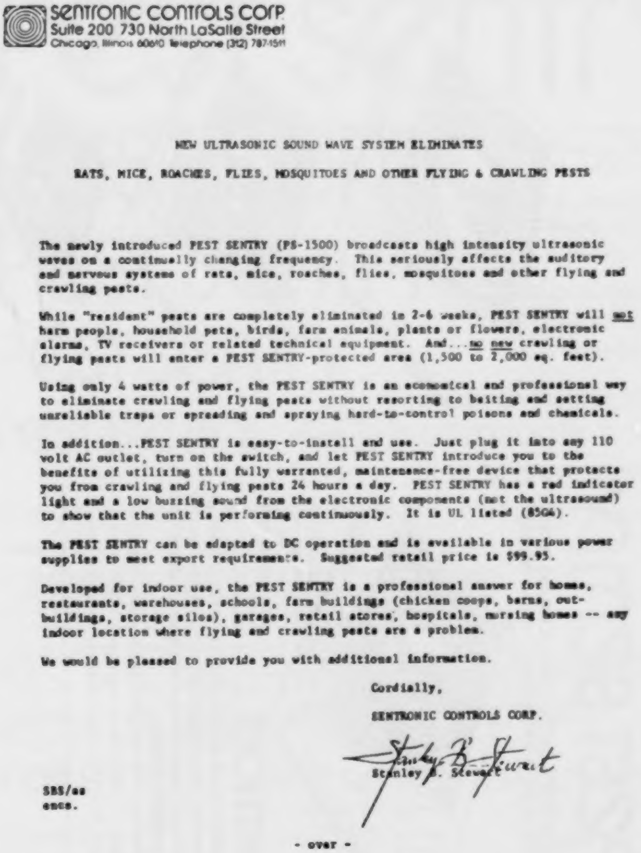


EXHIBIT B-1-1



SENTRONIC CONTROLS CORP.
Suite 200 730 North LaSalle Street
Chicago, Illinois 60610 Telephone (312) 787-1511

NEW ULTRASONIC SOUND WAVE SYSTEM ELIMINATES

RATS, MICE, ROACHES, FLIES, MOSQUITOES AND OTHER FLYING & CRAWLING PESTS

The newly introduced PEST SENTRY (PS-1500) broadcasts high intensity ultrasonic waves on a continually changing frequency. This seriously affects the auditory and nervous systems of rats, mice, roaches, flies, mosquitoes and other flying and crawling pests.

While "resident" pests are completely eliminated in 2-6 weeks, PEST SENTRY will not harm people, household pets, birds, farm animals, plants or flowers, electronic alarms, TV receivers or related technical equipment. And...no new crawling or flying pests will enter a PEST SENTRY-protected area (1,500 to 2,000 sq. feet).

Using only 4 watts of power, the PEST SENTRY is an economical and professional way to eliminate crawling and flying pests without resorting to baiting and setting unreliable traps or spreading and spraying hard-to-control poisons and chemicals.

In addition...PEST SENTRY is easy-to-install and use. Just plug it into any 110 volt AC outlet, turn on the switch, and let PEST SENTRY introduce you to the benefits of utilizing this fully warranted, maintenance-free device that protects you from crawling and flying pests 24 hours a day. PEST SENTRY has a red indicator light and a low buzzing sound from the electronic components (not the ultrasound) to show that the unit is performing continuously. It is UL listed (85G4).

The PEST SENTRY can be adapted to DC operation and is available in various power supplies to meet export requirements. Suggested retail price is $99.95.

Developed for indoor use, the PEST SENTRY is a professional answer for homes, restaurants, warehouses, schools, farm buildings (chicken coops, barns, outbuildings, storage silos), garages, retail stores, hospitals, nursing homes -- any indoor location where flying and crawling pests are a problem.

We would be pleased to provide you with additional information.

Cordially,

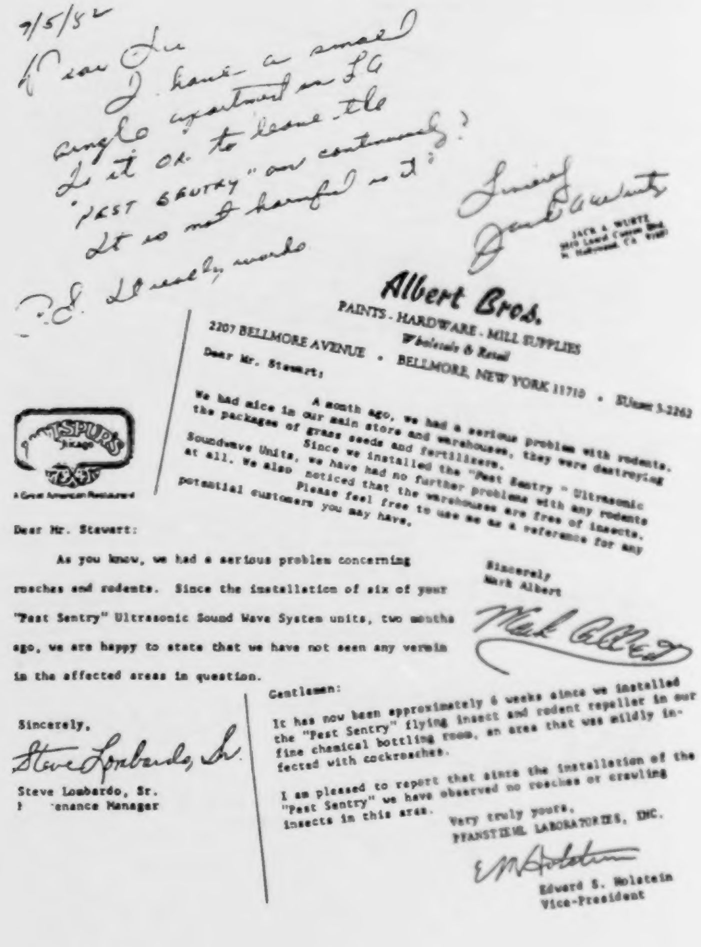
SENTRONIC CONTROLS CORP.

Stanley B. Stewart

SBS/ss
encs.

- over -

EXHIBIT B-1-2



7/5/82
Dear Sir
I have a small
single apartment in LA
Is it OK to leave the
"PEST SENTRY" on continuously?
It is not harmful is it?
P.S. It really works

Sincerely
Jack A Wurtz

JACK A. WURTZ
[illegible] Laurel Canyon Blvd.
N. Hollywood Ca [illegible]

Albert Bros.
PAINTS - HARDWARE - MILL SUPPLIES
Wholesale & Retail
2207 BELLMORE AVENUE • BELLMORE, NEW YORK 11710 • SUnset 5-2262

Dear Mr. Stewart;

A month ago, we had a serious problem with rodents. We had mice in our main store and warehouses, they were destroying the packages of grass seeds and fertilizers.

Since we installed the "Pest Sentry" Ultrasonic Soundwave Units, we have had no further problems with any rodents at all. We also noticed that the warehouses are free of insects.

Please feel free to use me as a reference for any potential customers you may have.

Sincerely
Mark Albert

Mark Albert

A Great American Restaurant

Dear Mr. Stewart:

As you know, we had a serious problem concerning roaches and rodents. Since the installation of six of your "Pest Sentry" Ultrasonic Sound Wave System units, two months ago, we are happy to state that we have not seen any vermin in the affected areas in question.

Sincerely,

Steve Lombardo, Sr.

Steve Lombardo, Sr.
[illegible]enance Manager

Gentlemen:

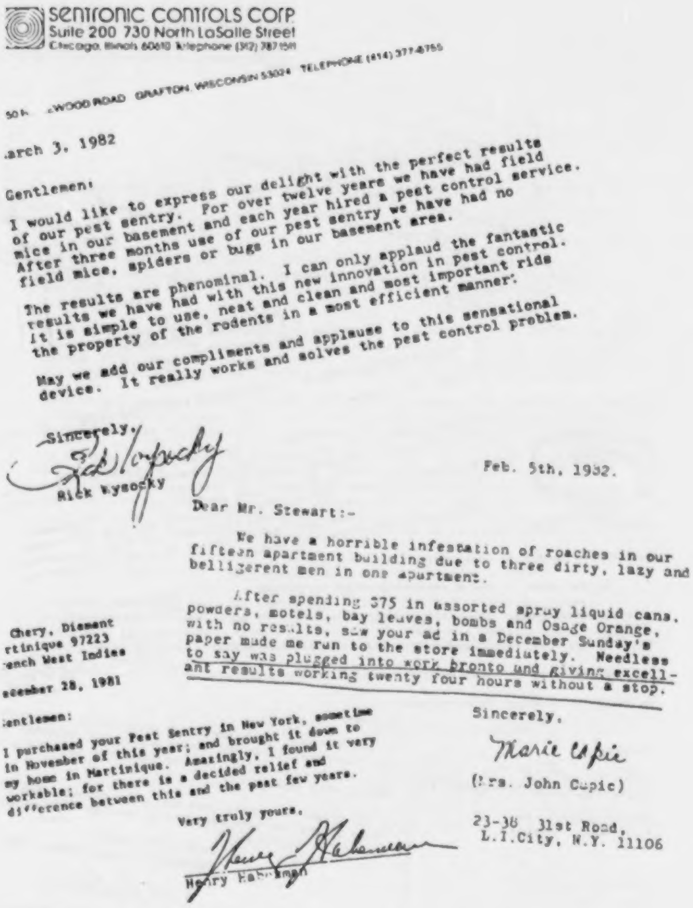
It has now been approximately 6 weeks since we installed the "Pest Sentry" flying insect and rodent repeller in our fine chemical bottling room, an area that was mildly infected with cockroaches.

I am pleased to report that since the installation of the "Pest Sentry" we have observed no roaches or crawling insects in this area.

Very truly yours,
PFANSTIEHL LABORATORIES, INC.

Edward S. Holstein
Vice-President

EXHIBIT B-1-3



Sentronic Controls Corp
Suite 200 730 North LaSalle Street
Chicago, Illinois 60610 Telephone (312) 787 1511

50 N [illegible]WOOD ROAD GRAFTON, WISCONSIN 53024 TELEPHONE (414) 377-8755

arch 3, 1982

Gentlemen:

I would like to express our delight with the perfect results of our pest sentry. For over twelve years we have had field mice in our basement and each year hired a pest control service. After three months use of our pest sentry we have had no field mice, spiders or bugs in our basement area.

The results are phenominal. I can only applaud the fantastic results we have had with this new innovation in pest control. It is simple to use, neat and clean and most important rids the property of the rodents in a most efficient manner.

May we add our compliments and applause to this sensational device. It really works and solves the pest control problem.

Sincerely,

Rick Wysocky

Feb. 5th, 1932.

Dear Mr. Stewart:-

We have a horrible infestation of roaches in our fifteen apartment building due to three dirty, lazy and belligerent men in one apartment.

After spending 375 in assorted spray liquid cans, powders, motels, bay leaves, bombs and Osage Orange, with no results, saw your ad in a December Sunday's paper made me run to the store immediately. Needless to say was plugged into work pronto and giving excellant results working twenty four hours without a stop.

Sincerely,

Marie Cupic

(Mrs. John Cupic)

23-38 31st Road,
L.I.City, N.Y. 11106

Chery, Diement
rtinique 97223
ench West Indies

ecember 28, 1981

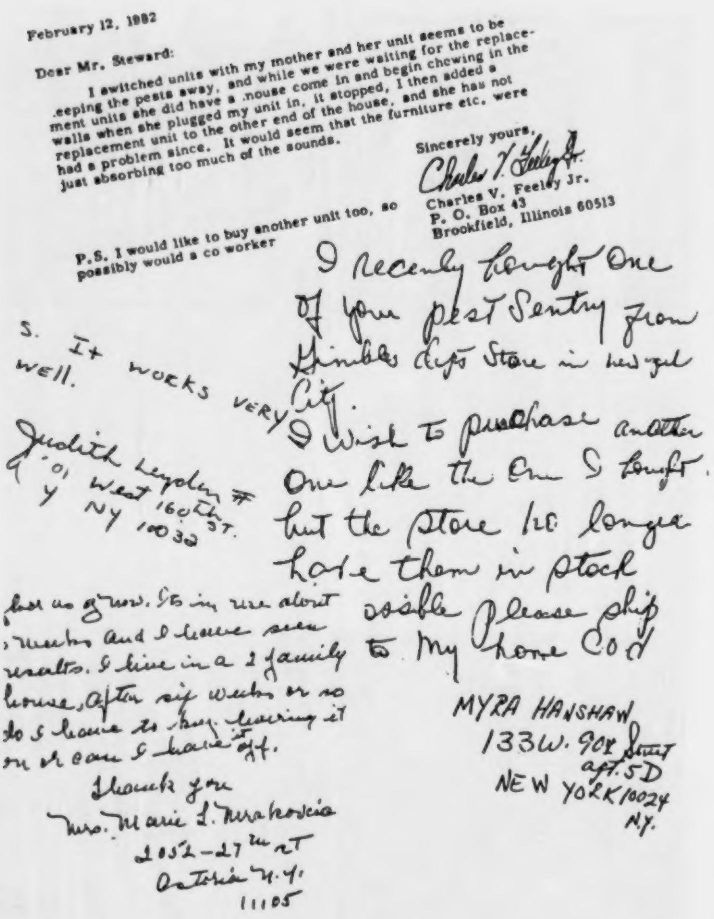
entlemen:

I purchased your Pest Sentry in New York, sometime in November of this year; and brought it down to my home in Martinique. Amazingly, I found it very workable; for there is a decided relief and difference between this and the past few years.

Very truly yours,

Henry Haberman

EXHIBIT B-1-4



February 12, 1982

Dear Mr. Steward:

I switched units with my mother and her unit seems to be .eeping the pests away, and while we were waiting for the replacement units she did have a .nouse come in and begin chewing in the walls when she plugged my unit in, it stopped, I then added a replacement unit to the other end of the house, and she has not had a problem since. It would seem that the furniture etc. were just absorbing too much of the sounds.

Sincerely yours,
Charles V. Feeley Jr.

Charles V. Feeley Jr.
P. O. Box 43
Brookfield, Illinois 60513

P.S. I would like to buy another unit too, so possibly would a co worker

---

I recently bought One
Of your pest Sentry from
Gimbles dept Store in New York
City.
I Wish to purchase another
One like the One I bought.
but the store no longer
have them in stock
ossible please ship
to My home C.O.D

MYRA HANSHAW
133 W. 90th Street
apt. 5D
NEW YORK 10024
N.Y.

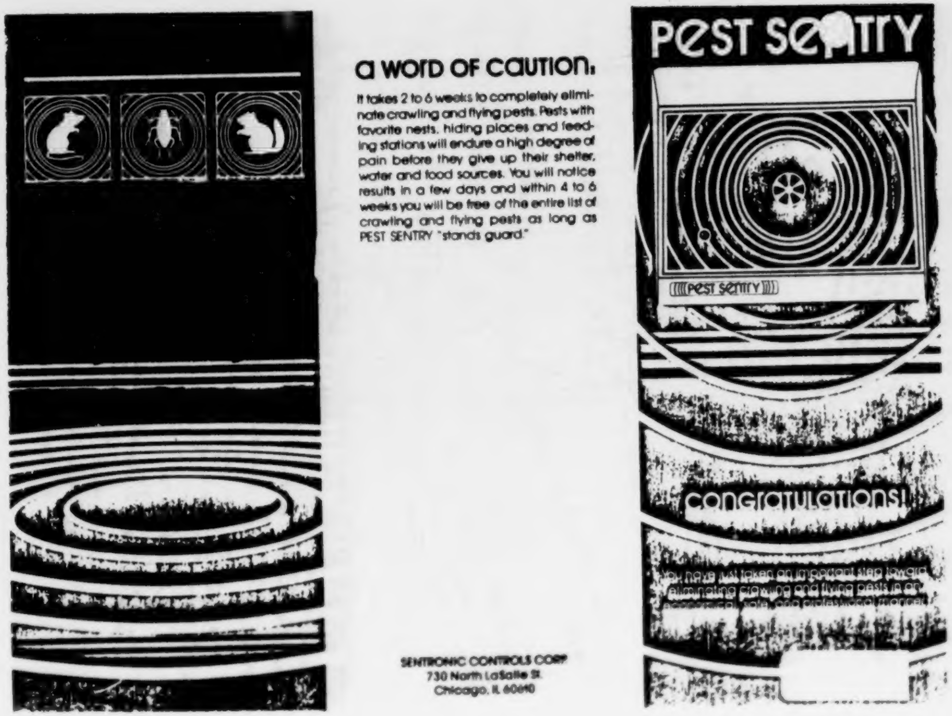
S. It works very well.

Judith Leydon #
01 West 160th St.
Y NY 10032

[illegible] as of now. Its in use about
weeks and I have seen
results. I live in a 2 family
house, after six weeks or so
so I have to keep leaving it
on or can I leave it off.

Thank you
Mrs. Marie L. Mrakovcic
2052-27th st
Astoria N.Y.
11105

EXHIBIT B-2-1



a word of caution:

It takes 2 to 6 weeks to completely eliminate crawling and flying pests. Pests with favorite nests, hiding places and feeding stations will endure a high degree of pain before they give up their shelter, water and food sources. You will notice results in a few days and within 4 to 6 weeks you will be free of the entire list of crawling and flying pests as long as PEST SENTRY "stands guard."

SENTRONIC CONTROLS CORP
730 North LaSalle St.
Chicago, IL 60610

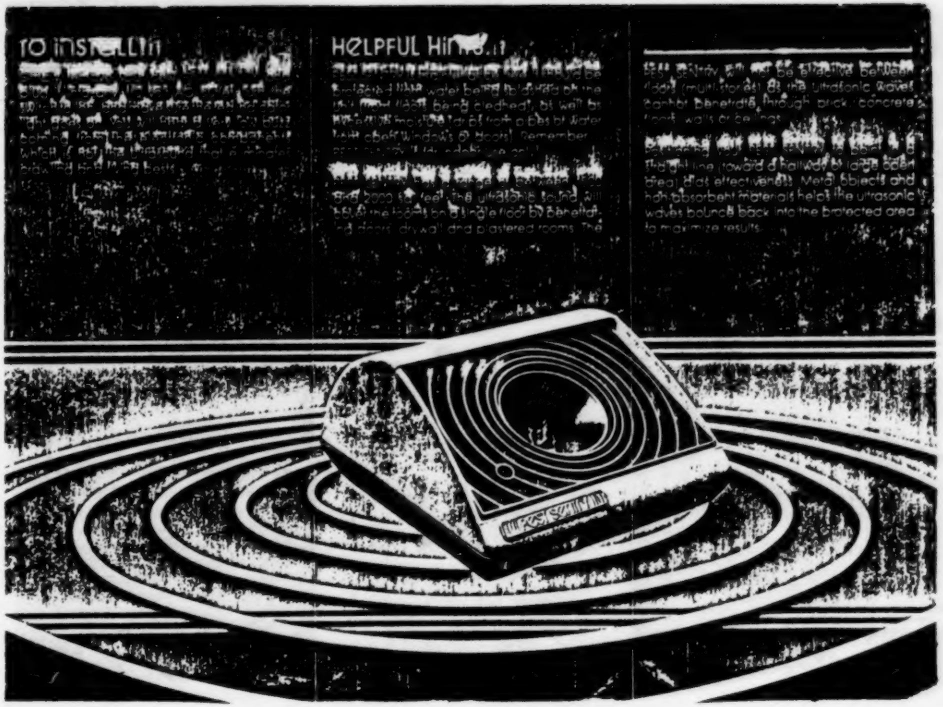
PEST SENTRY

((((PEST SENTRY))))

congratulations!

You have just taken an important step toward eliminating crawling and flying pests in an economical, safe, and professional manner.

EXHIBIT B-2-2



TO INSTALLIN [illegible]

[illegible]

HELPFUL HIN[illegible]

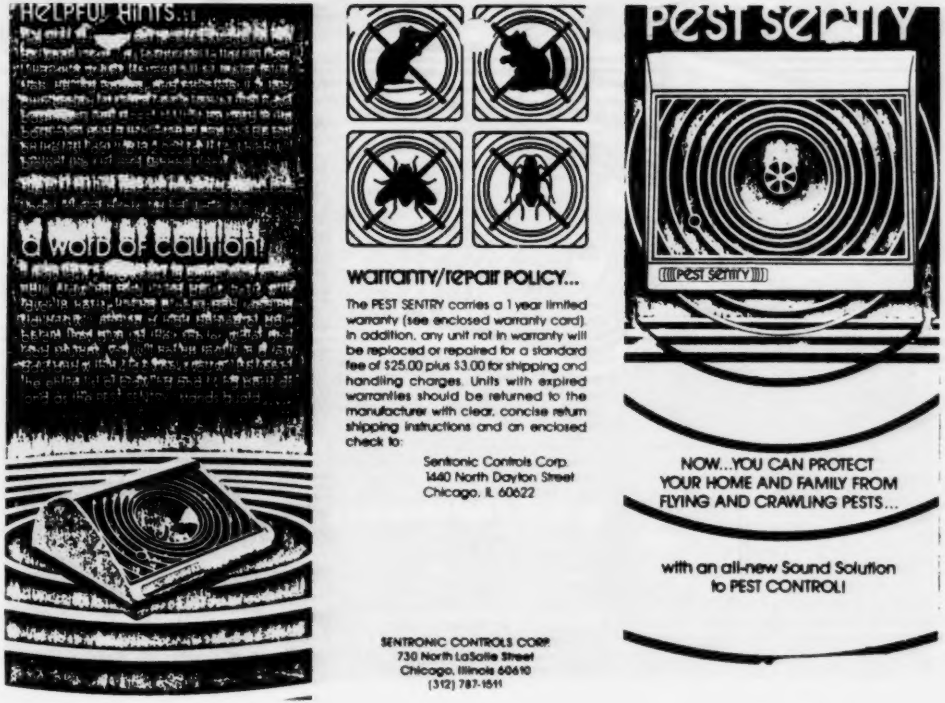
[illegible] protected [illegible] water being splashed on the unit [illegible] being sprayed, as well as [illegible] moisture (drips from pipes or water leaking from windows & doors). Remember [illegible]

[illegible] 2000 sq. feet, the ultrasonic sound will cover the rooms on a single floor by penetrating doors, drywall and plastered rooms. The [illegible]

[illegible] SENTRY will not be effective between floors (multi-stories) as the ultrasonic waves cannot penetrate through brick, concrete floors, walls or ceilings.

[illegible] straight line (toward a hallway or large open area) aids effectiveness. Metal objects and non-absorbent materials helps the ultrasonic waves bounce back into the protected area to maximize results.

EXHIBIT B-3-1



HELPFUL HINTS...

a word of caution!

warranty/repair POLICY...

The PEST SENTRY carries a 1 year limited warranty (see enclosed warranty card). In addition, any unit not in warranty will be replaced or repaired for a standard fee of $25.00 plus $3.00 for shipping and handling charges. Units with expired warranties should be returned to the manufacturer with clear, concise return shipping instructions and an enclosed check to:

Sentronic Controls Corp.
1440 North Dayton Street
Chicago, IL 60622

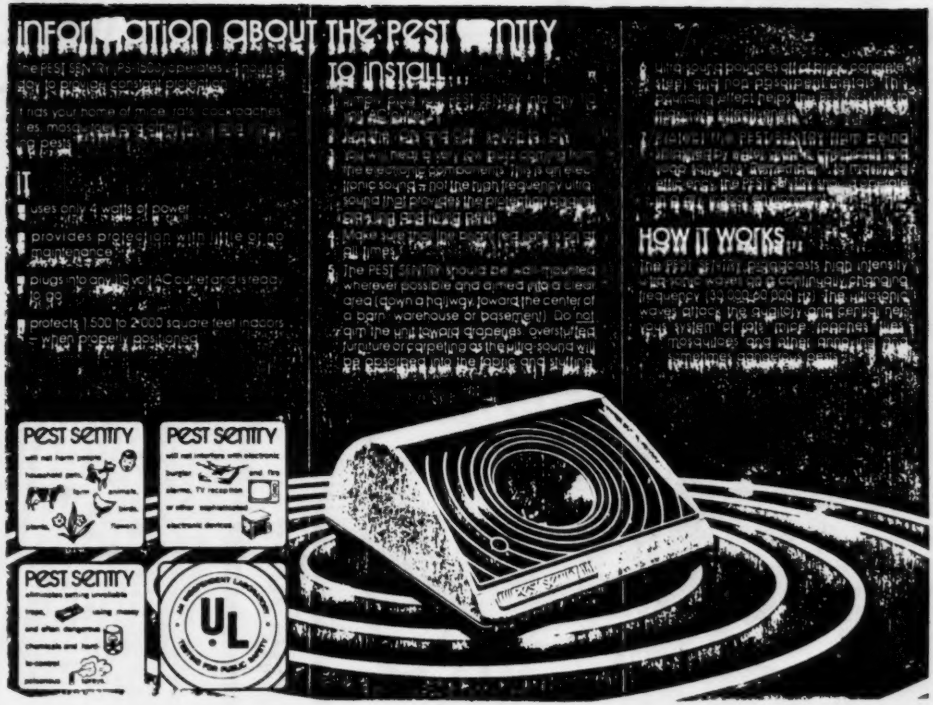
SENTRONIC CONTROLS CORP.
730 North LaSalle Street
Chicago, Illinois 60610
(312) 787-1511

pest sentry

NOW...YOU CAN PROTECT YOUR HOME AND FAMILY FROM FLYING AND CRAWLING PESTS...

with an all-new Sound Solution to PEST CONTROL!

EXHIBIT B-3-2



INFORMATION ABOUT THE PEST SENTRY

The PEST SENTRY (PS-1500) operates 24 hours a day to provide constant protection.

It rids your home of mice, rats, cockroaches, flies, mosquitoes and other flying and crawling pests.

IT

- uses only 4 watts of power
- provides protection with little or no maintenance
- plugs into any 110 volt AC outlet and is ready to go
- protects 1,500 to 2,000 square feet indoors — when properly positioned

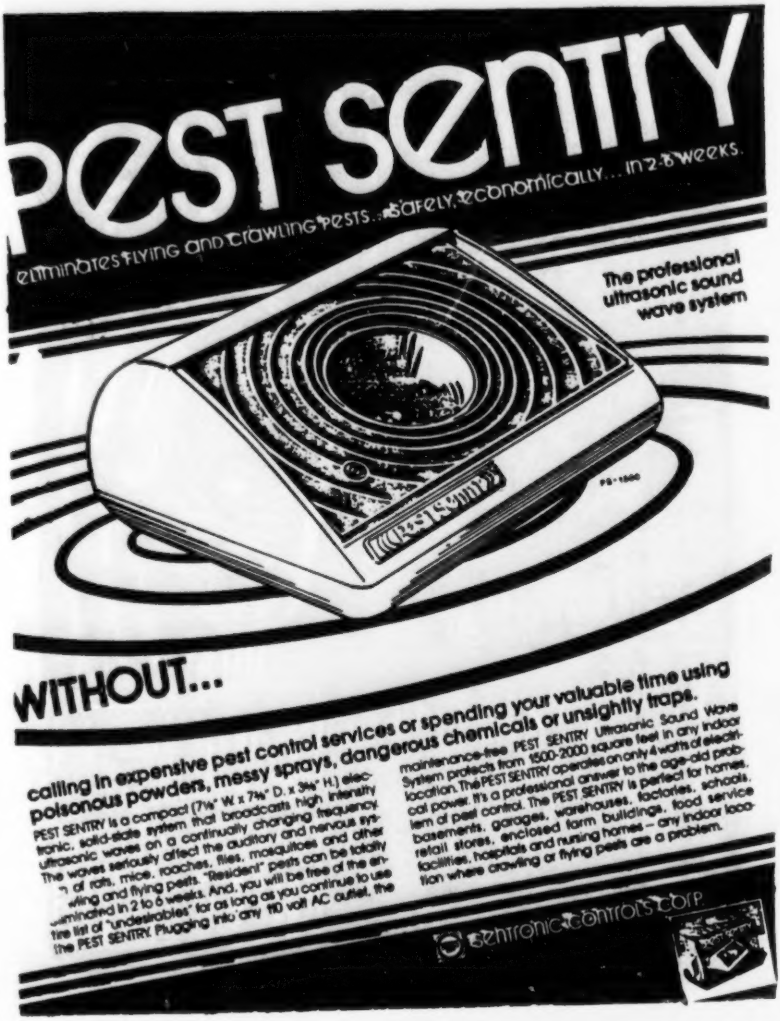
TO INSTALL...

1. Simply plug your PEST SENTRY into any 110 volt AC outlet.
2. Turn the "ON and OFF" switch to "ON".
3. You will hear a very low buzz coming from the electronic components. This is an electronic sound — not the high frequency ultrasound that provides the protection against crawling and flying pests.
4. Make sure that the bright red light is on at all times.
5. The PEST SENTRY should be wall-mounted wherever possible and aimed into a clear area (down a hallway, toward the center of a barn, warehouse or basement). Do not aim the unit toward draperies, overstuffed furniture or carpeting as the ultra-sound will be absorbed into the fabric and stuffing.
6. Ultra-sound bounces off of brick, concrete, steel and non-absorbent metals. This bouncing effect helps the PEST SENTRY to maximize effectiveness.
7. Protect the PEST SENTRY from being splashed by water, grease, chemicals and soap solutions. Remember — to maximize efficiency, the PEST SENTRY should operate in a dry indoor environment.

HOW IT WORKS...

The PEST SENTRY broadcasts high intensity ultrasonic waves at a continually changing frequency (30,000-60,000 Hz). The ultrasonic waves attack the auditory and central nervous system of rats, mice, roaches, flies, mosquitoes and other annoying and sometimes dangerous pests.

EXHIBIT B-4-1



PEST SENTRY

eliminates flying and crawling pests... safely, economically... in 2-6 weeks.

The professional ultrasonic sound wave system

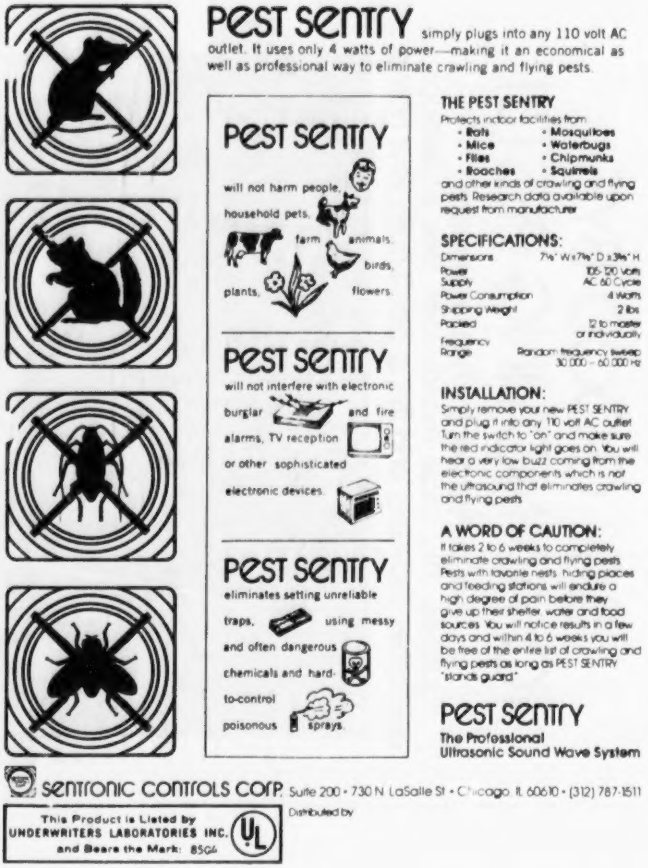
WITHOUT...

calling in expensive pest control services or spending your valuable time using poisonous powders, messy sprays, dangerous chemicals or unsightly traps.

PEST SENTRY is a compact (7⅛" W. x 7⅝" D. x 3⅝" H.) electronic, solid-state system that broadcasts high intensity ultrasonic waves on a continually changing frequency. The waves seriously affect the auditory and nervous system of rats, mice, roaches, flies, mosquitoes and other crawling and flying pests. "Resident" pests can be totally eliminated in 2 to 6 weeks. And, you will be free of the entire list of "undesirables" for as long as you continue to use the PEST SENTRY. Plugging into any 110 volt AC outlet, the maintenance-free PEST SENTRY Ultrasonic Sound Wave System protects from 1500-2000 square feet in any indoor location. The PEST SENTRY operates on only 4 watts of electrical power. It's a professional answer to the age-old problem of pest control. The PEST SENTRY is perfect for homes, basements, garages, warehouses, factories, schools, retail stores, enclosed farm buildings, food service facilities, hospitals and nursing homes—any indoor location where crawling or flying pests are a problem.

sentronic controls corp.

EXHIBIT B-4-2



PEST SENTRY simply plugs into any 110 volt AC outlet. It uses only 4 watts of power—making it an economical as well as professional way to eliminate crawling and flying pests.

PEST SENTRY

will not harm people, household pets, farm animals, birds, plants, flowers.

PEST SENTRY

will not interfere with electronic burglar and fire alarms, TV reception or other sophisticated electronic devices.

PEST SENTRY

eliminates setting unreliable traps, using messy and often dangerous chemicals and hard-to-control poisonous sprays.

THE PEST SENTRY

Protects indoor facilities from

- **Rats**
- **Mice**
- **Flies**
- **Roaches**
- **Mosquitoes**
- **Waterbugs**
- **Chipmunks**
- **Squirrels**

and other kinds of crawling and flying pests. Research data available upon request from manufacturer.

SPECIFICATIONS:

Dimensions	7[illegible]" W x 7[illegible]" D x 3[illegible]" H
Power Supply	105-120 Volts AC 60 Cycle
Power Consumption	4 Watts
Shipping Weight	2 lbs.
Packed	12 to master or individually
Frequency Range	Random frequency sweep 30,000 – 60,000 Hz

INSTALLATION:

Simply remove your new PEST SENTRY and plug it into any 110 volt AC outlet. Turn the switch to "on" and make sure the red indicator light goes on. You will hear a very low buzz coming from the electronic components which is not the ultrasound that eliminates crawling and flying pests.

A WORD OF CAUTION:

It takes 2 to 6 weeks to completely eliminate crawling and flying pests. Pests with favorite nests, hiding places and feeding stations will endure a high degree of pain before they give up their shelter, water and food sources. You will notice results in a few days and within 4 to 6 weeks you will be free of the entire list of crawling and flying pests as long as PEST SENTRY "stands guard."

PEST SENTRY

The Professional
Ultrasonic Sound Wave System

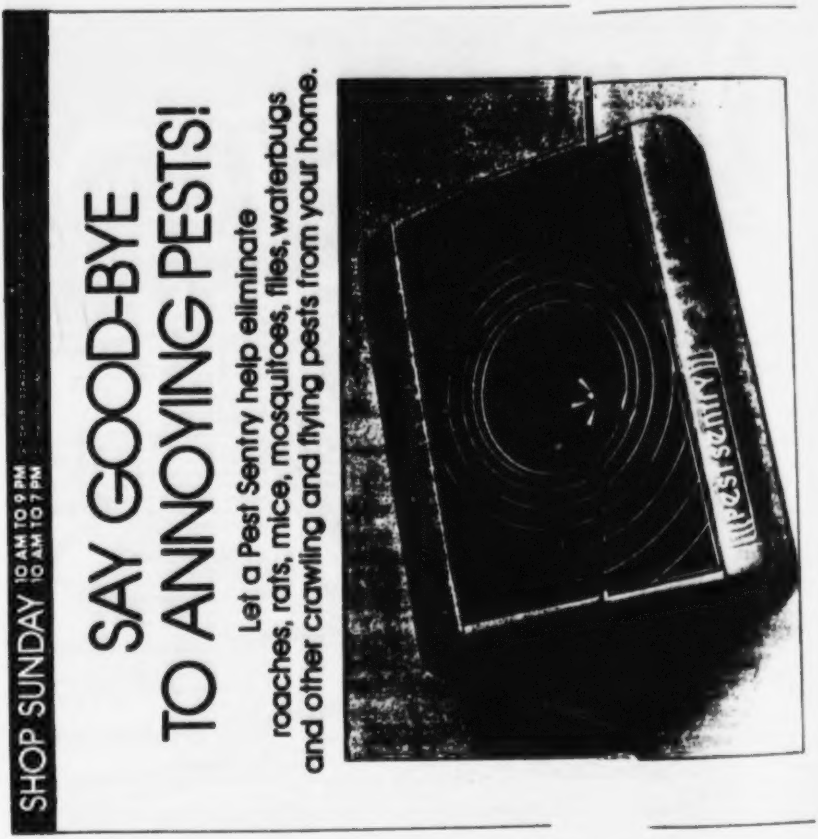
SENTRONIC CONTROLS CORP. Suite 200 • 730 N. LaSalle St. • Chicago, IL 60610 • (312) 787-1511

This Product is Listed by
UNDERWRITERS LABORATORIES INC.
and Bears the Mark: 85G4

UL

Distributed by

EXHIBIT C-1

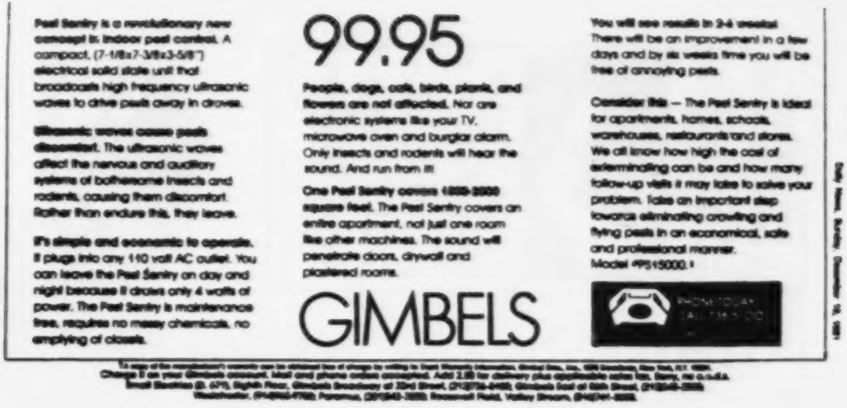


SHOP SUNDAY 10 AM TO 9 PM
10 AM TO 7 PM

SAY GOOD-BYE
TO ANNOYING PESTS!

Let a Pest Sentry help eliminate roaches, rats, mice, mosquitoes, flies, waterbugs and other crawling and flying pests from your home.

EXHIBIT C-1 (CONT'D)



Daily News, Sunday, December 13, 1981

Pest Sentry is a revolutionary new concept in indoor pest control. A compact, (7-1/8x7-3/8x3-5/8") electrical solid state unit that broadcasts high frequency ultrasonic waves to drive pests away in droves.

Ultrasonic waves cause pests discomfort. The ultrasonic waves affect the nervous and auditory systems of bothersome insects and rodents, causing them discomfort. Rather than endure this, they leave.

It's simple and economic to operate. It plugs into any 110 volt AC outlet. You can leave the Pest Sentry on day and night because it draws only 4 watts of power. The Pest Sentry is maintenance free, requires no messy chemicals, no emptying of closets.

99.95

People, dogs, cats, birds, plants, and flowers are not affected. Nor are electronic systems like your TV, microwave oven and burglar alarm. Only insects and rodents will hear the sound. And run from it!

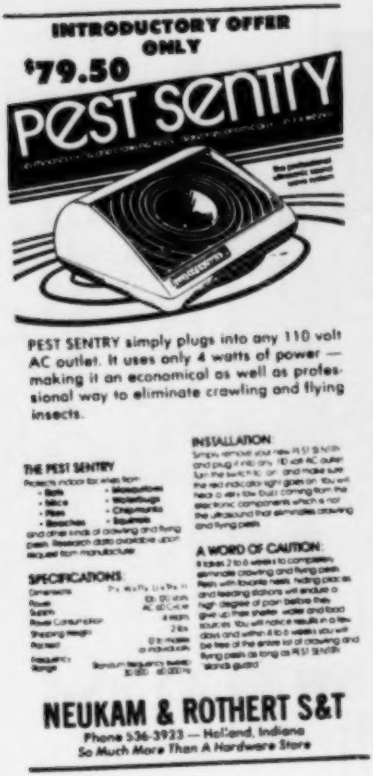
One Pest Sentry covers 1500-2000 square feet. The Pest Sentry covers an entire apartment, not just one room like other machines. The sound will penetrate doors, drywall and plastered rooms.

GIMBELS

You will see results in 2-6 weeks! There will be an improvement in a few days and by six weeks time you will be free of annoying pests.

Consider this — The Pest Sentry is ideal for apartments, homes, schools, warehouses, restaurants and stores. We all know how high the cost of exterminating can be and how many follow-up visits it may take to solve your problem. Take an important step towards eliminating crawling and flying pests in an economical, safe and professional manner.
Model #PS15000.¹

EXHIBIT C-2-1



INTRODUCTORY OFFER ONLY

$79.50

PEST SENTRY

PEST SENTRY simply plugs into any 110 volt AC outlet. It uses only 4 watts of power — making it an economical as well as professional way to eliminate crawling and flying insects.

THE PEST SENTRY

Protects indoor facilities from:

- Rats
- Mice
- Fleas
- Roaches
- Mosquitoes
- Waterbugs
- Chipmunks
- Squirrels

and other kinds of crawling and flying pests. Research data available upon request from manufacturer.

SPECIFICATIONS:

Dimensions	[illegible]
Power Supply	[illegible]
Power Consumption	4 watts
Shipping Weight	2 lbs.
Packed	[illegible]
Frequency Range	[illegible]

INSTALLATION:

Simply remove your new PEST SENTRY and plug it into any 110 volt AC outlet. Turn the switch to "on" and make sure the red indicator light goes on. You will hear a very low buzz coming from the electronic components which is not the ultrasound that eliminates crawling and flying pests.

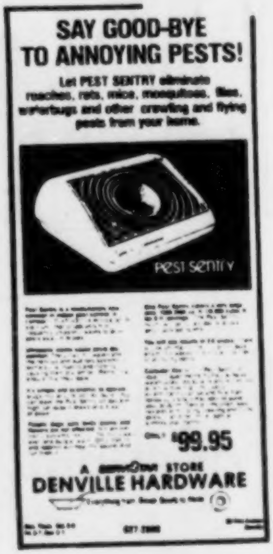
A WORD OF CAUTION:

It takes 2 to 6 weeks to completely eliminate crawling and flying pests. Pests with favorite nests, hiding places and feeding stations will endure a high degree of pain before they give up their shelter, water and food sources. You will notice results in a few days and within 4 to 6 weeks you will be free of the entire lot of crawling and flying pests as long as PEST SENTRY "stands guard."

NEUKAM & ROTHERT S&T

Phone 536-3923 — Holland, Indiana

So Much More Than A Hardware Store



SAY GOOD-BYE TO ANNOYING PESTS!

Let PEST SENTRY eliminate roaches, rats, mice, mosquitoes, flies, waterbugs and other crawling and flying pests from your home.

PEST SENTRY

ONLY $99.95

A [illegible] STORE

DENVILLE HARDWARE

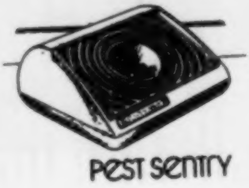
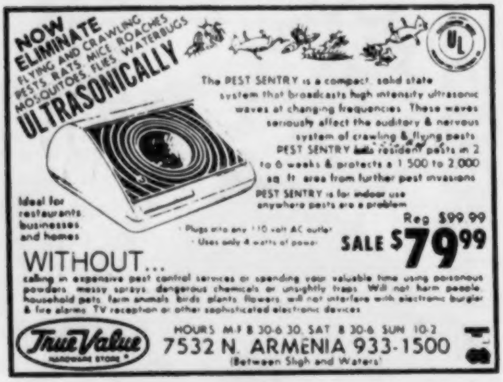


EXHIBIT C-2-2



NOW ELIMINATE FLYING AND CRAWLING PESTS, RATS, MICE, ROACHES, MOSQUITOES, FLIES, WATERBUGS ULTRASONICALLY

The PEST SENTRY is a compact, solid state system that broadcasts high intensity ultrasonic waves at changing frequencies. These waves seriously affect the auditory & nervous system of crawling & flying pests. PEST SENTRY [illegible] resident pests in 2 to 6 weeks & protects a 1,500 to 2,000 sq. ft. area from further pest invasions. PEST SENTRY is for indoor use anywhere pests are a problem.

Ideal for restaurants, businesses and homes

- Plugs into any 110 volt AC outlet
- Uses only 4 watts of power

Reg. $99.99

SALE $79.99

WITHOUT...

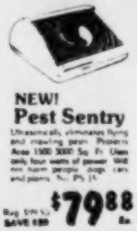
calling in expensive pest control services or spending your valuable time using poisonous powders, messy sprays, dangerous chemicals or unsightly traps. Will not harm people, household pets, farm animals, birds, plants, flowers; will not interfere with electronic burglar & fire alarms, TV reception or other sophisticated electronic devices.

True Value HARDWARE STORE

HOURS M-F 8:30-6:30, SAT 8:30-6, SUN 10-2

7532 N. ARMENIA 933-1500

(Between Sligh and Waters)

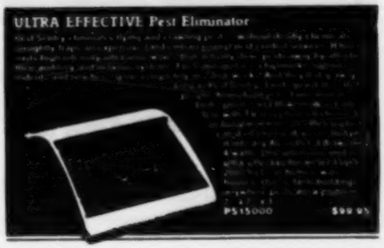


NEW!

Pest Sentry

Ultrasonically eliminates flying and crawling pests. Protects Area 1500-3000 Sq. Ft. Uses only four watts of power. Will not harm people, dogs, cats and plants. No. PS 15

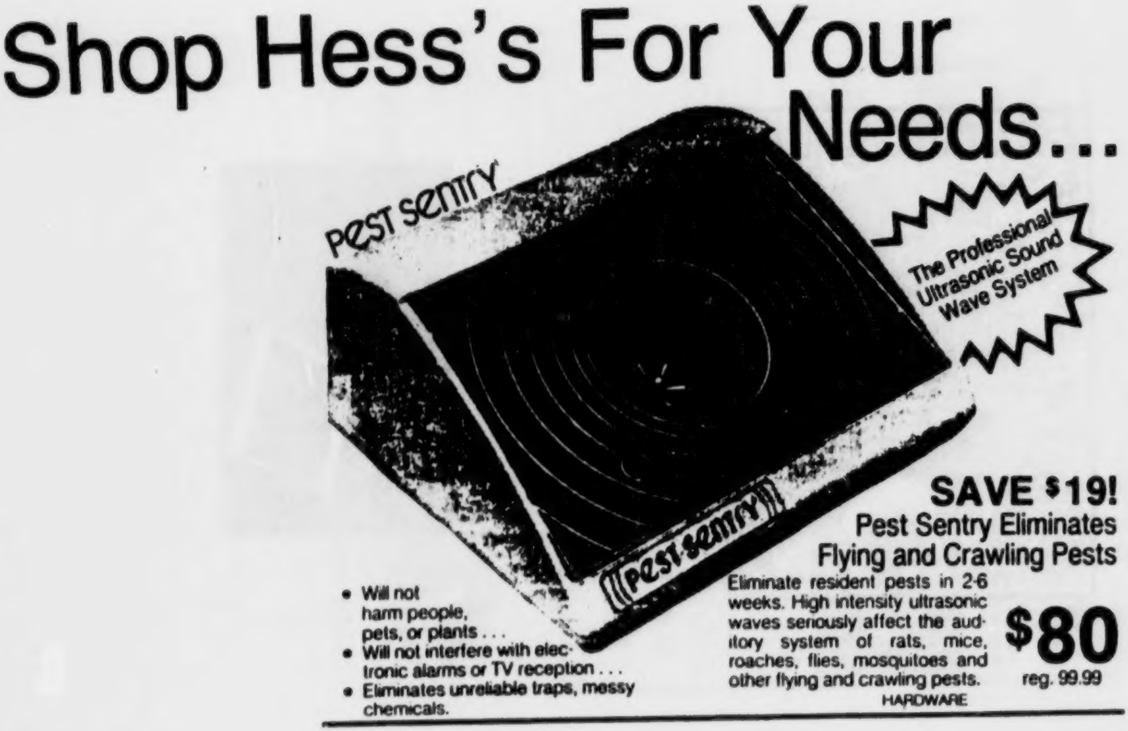
Reg. $99.95 SAVE $20 $79.88 Ea.



ULTRA EFFECTIVE Pest Eliminator

PS15000 $99.95

EXHIBIT C-2-3


PEST SENTRY
PEST SENTRY

Shop Hess's For Your Needs...

The Professional Ultrasonic Sound Wave System

SAVE $19!

Pest Sentry Eliminates Flying and Crawling Pests

Eliminate resident pests in 2-6 weeks. High intensity ultrasonic waves seriously affect the auditory system of rats, mice, roaches, flies, mosquitoes and other flying and crawling pests.

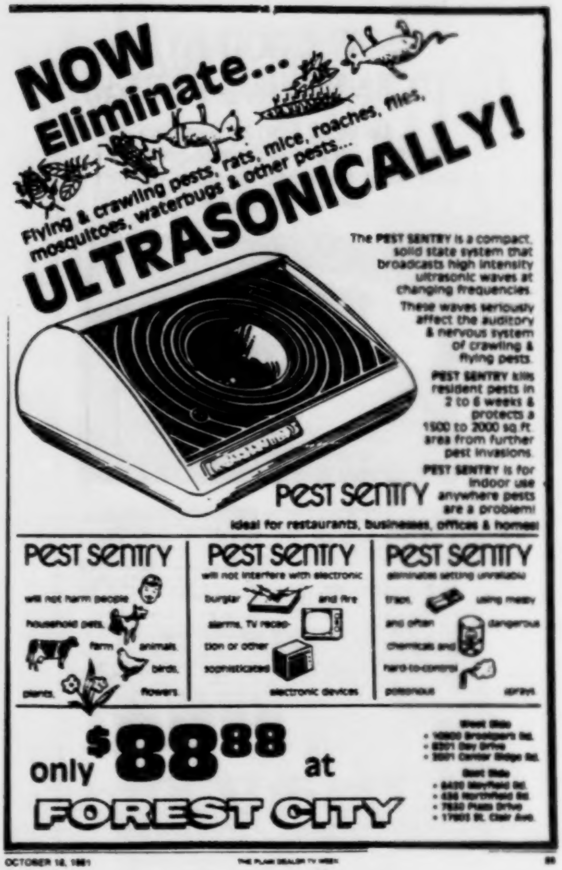
$80

reg. 99.99

HARDWARE

- Will not harm people, pets, or plants . . .
- Will not interfere with electronic alarms or TV reception . . .
- Eliminates unreliable traps, messy chemicals.

EXHIBIT C-2-4



NOW Eliminate...

Flying & crawling pests, rats, mice, roaches, flies, mosquitoes, waterbugs & other pests...

ULTRASONICALLY!

The PEST SENTRY is a compact, solid state system that broadcasts high intensity ultrasonic waves at changing frequencies.

These waves seriously affect the auditory & nervous system of crawling & flying pests.

PEST SENTRY kills resident pests in 2 to 6 weeks & protects a 1500 to 2000 sq ft. area from further pest invasions.

PEST SENTRY is for indoor use anywhere pests are a problem!

pest sentry

Ideal for restaurants, businesses, offices & homes!

pest sentry

will not harm people household pets, farm animals, birds, plants, flowers.

pest sentry

will not interfere with electronic burglar and fire alarms, TV reception or other sophisticated electronic devices

pest sentry

eliminates setting unreliable traps, using messy and often dangerous chemicals and hard-to-control poisonous sprays

only $88.88 at

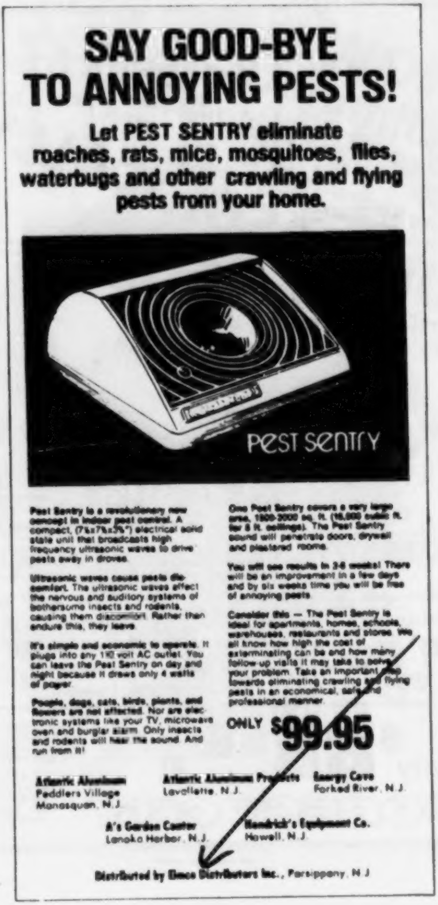
FOREST CITY

West Side
- 10900 Brookpark Rd.
- 6201 Day Drive
- 3001 Center Ridge Rd.

East Side
- 6420 Mayfield Rd.
- 436 Northfield Rd.
- 7830 Plaza Drive
- 17801 St. Clair Ave.

OCTOBER 18, 1981 THE PLAIN DEALER TV WEEK 89

EXHIBIT C-2-5



SAY GOOD-BYE TO ANNOYING PESTS!

Let PEST SENTRY eliminate roaches, rats, mice, mosquitoes, flies, waterbugs and other crawling and flying pests from your home.

PEST SENTRY

Pest Sentry is a revolutionary new concept in indoor pest control. A compact, (7¾x7¾x3¾") electrical solid state unit that broadcasts high frequency ultrasonic waves to drive pests away in droves.

Ultrasonic waves cause pests discomfort. The ultrasonic waves effect the nervous and auditory systems of bothersome insects and rodents, causing them discomfort. Rather than endure this, they leave.

It's simple and economic to operate. It plugs into any 110 volt AC outlet. You can leave the Pest Sentry on day and night because it draws only 4 watts of power.

People, dogs, cats, birds, plants, and flowers are not affected. Nor are electronic systems like your TV, microwave oven and burglar alarm. Only insects and rodents will hear the sound. And run from it!

One Pest Sentry covers a very large area, 1500-2000 sq. ft. (16,000 cubic ft. for 8 ft. ceilings). The Pest Sentry sound will penetrate doors, drywall and plastered rooms.

You will see results in 2-6 weeks! There will be an improvement in a few days and by six weeks time you will be free of annoying pests.

Consider this — The Pest Sentry is ideal for apartments, homes, schools, warehouses, restaurants and stores. We all know how high the cost of exterminating can be and how many follow-up visits it may take to solve your problem. Take an important step towards eliminating crawling and flying pests in an economical, safe and professional manner.

ONLY $99.95

Atlantic Aluminum
Peddlers Village
Manasquan, N.J.

Atlantic Aluminum Products
Lavallette, N.J.

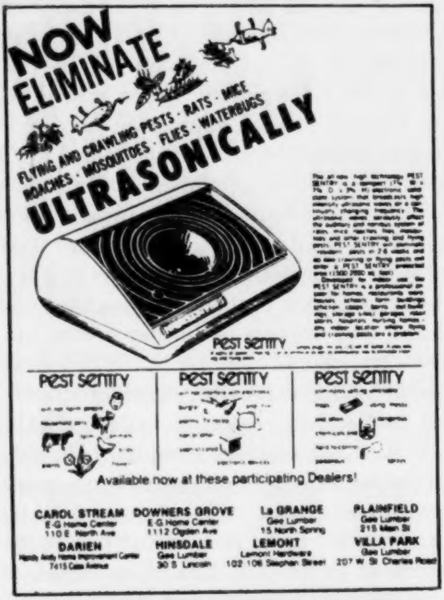
Energy Cave
Forked River, N.J.

A's Garden Center
Lanoka Harbor, N.J.

Hendrick's Equipment Co.
Howell, N.J.

Distributed by Elmco Distributors Inc., Parsippany, N.J.

EXHIBIT C-2-6



NOW ELIMINATE

FLYING AND CRAWLING PESTS · RATS · MICE

ROACHES · MOSQUITOES · FLIES · WATERBUGS

ULTRASONICALLY

PEST SENTRY

PEST SENTRY

PEST SENTRY

PEST SENTRY

Available now at these participating Dealers!

CAROL STREAM
E-G Home Center
110 E. North Ave

DARIEN
Handy Andy Home Improvement Center
7415 Cass Avenue

DOWNERS GROVE
E-G Home Center
1112 Ogden Ave

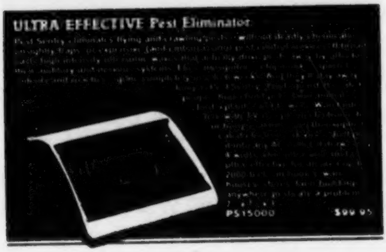
HINSDALE
Gee Lumber
30 S. Lincoln

La GRANGE
Gee Lumber
15 North Spring

LEMONT
Lemont Hardware
102 106 Stephen Street

PLAINFIELD
Gee Lumber
215 Main St

VILLA PARK
Gee Lumber
207 W. St. Charles Road



ULTRA EFFECTIVE Pest Eliminator

PS15000 $99.95

DECISION AND ORDER

The Federal Trade Commission, having initiated an investigation of certain acts and practices of the respondents named in the caption hereof, and the respondents having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondents with violation of the Federal Trade Commission Act; and

The respodnents, their attorneys, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondents of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondents that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondents have violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondents Sentronic Controls Corporation and International Marketing and Manufacturing, Inc. are Illinois corporations with their offices and principal places of business located at 730 North LaSalle Street, Chicago, Illinois.

Respondent Unigraf, Inc. is an Illinois corporation with its principal place of business located at 60 West Erie Street, Chicago, Illinois.

Respondent Stanley Stewart is an officer of SCC and an officer of IMM. Respondent Anne K. Stewart is an officer of IMM. Respondent Richard Muller is a director of SCC and an officer and director of Unigraf.

As such, the individual respondents formulate, direct and control the policies, acts and practices of said corporations, and their business addresses are the same as those for said corporations.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondents, and the proceeding is in the public interest.

ORDER

PART I

It is ordered, That respondents Sentronic Controls Corporation, a corporation, its successors and assigns, and its officers, International Marketing & Manufacturing, Inc., a corporation, its successors and assigns, and its officers, Unigraf, Inc., a corporation, its successors and assigns, and its officers, and Stanley Stewart, Anne K. Stewart and Richard Muller, individually and as officers of said corporations, and respondents' agents, representatives, distributors, and employees, directly or through any corporation, subsidiary, division of other device, in connection with the advertising, offering for sale, sale or distribution of the Pest Sentry (PS–1500) or any other pest control product in or affecting commerce, as "commerce" is defined in the Federal Trade Commission act, do forthwith cease and desist from:

A. Representing, directly or by implication, that respondents' Pest Sentry (PS–1500) or any such ultrasonic product will:

(1) eliminate cockroaches, rats, mice and other pests from a home or place of business;

(2) eliminate rodent and insect problems from a home or place of business within two to six weeks, or within any other specified period of time;

(3) prevent rodents and insects from entering or remaining in an area where the ultrasonic product is in use in a home or place of business;

(4) protect, from rodent and insect infestations, areas up to 1500 square feet in a home or place of business, or within any other specified square footage area;

(5) serve as an effective alternative to the use of conventional products such as sprays, powders, traps or other chemicals in providing protection from insect and rodent infestation.

B. Representing, directly or by implication, any performance characteristic of any pest control product unless at the time of making such representation respondents possess and rely upon competent and reliable evidence which substantiates the representation. Evidence shall be competent and reliable only if tests, experiments, analyses, research studies, or other evaluations are conducted in an objective manner by persons qualified to do so, using procedures generally accepted in the relevant professions or sciences to yield accurate, reliable, and reproducible results.

C. Representing, directly or by implication, that any pest control product is effective in providing protection from insect and rodent infestation in a home or place of business unless at the time of making such representation respondents possess and rely upon competent and reliable evidence which either directly relates to such home or place of business use conditions or which can properly be applied to such conditions.

PART II

It is further ordered, That for three years after the last date of dissemination of the relevant representation respondents shall maintain and upon request make available to the Federal Trade Commission for inspection and copying copies of all materials relied upon to support any representation covered by Part I of this Order, and copies of all documents in respondents' possession that contradict, qualify, or otherwise call into question any such representations, including complaints from consumers.

PART III

It is further ordered, That respondents shall for a period of three years:

A. Distribute a copy of this Order to all managerial employees, distributors, independent sales agents and retailers present and future.

B. Notify each present and future distributor or sales representative that the failure to comply with the Order may result in cancellation of the distributorship or other selling agreement with respondents.

C. Require all distributors, independent sales agents and retailers to report to respondents semi-annually all consumer requests to refund and their action taken in response to such requests.

PART IV

It is further ordered, That for a period of ten years:

A. Respondents shall notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondents, such as dissolution, assignment, or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporation that may affect compliance obligations arising out of this Order.

B. The individual respondents named herein shall promptly notify the Commission of the discontinuance of their present pest control product business or employment and of their affiliation with any new pest control product business or employment, stating the nature of the business or employment in which the individual is newly engaged as well as a description of duties and responsibilities in connection with such new business or employment and the address of such new business and employment.

PART V

It is further ordered, That respondents shall, within sixty (60) days after service upon it of this Order, file with the Commission a report, in writing, setting forth in detail the manner and form in which it has complied with this Order.

Chairman Miller dissented.

IN THE MATTER OF

CHEVRON CORPORATION, ET AL.

MODIFYING ORDER IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT AND SEC. 7 OF THE CLAYTON ACT

Docket C-3147. Consent Order, Oct. 24, 1984—Modifying Order, March 13, 1985

After a "Request For Termination of Hold Separate Agreement" (Request) filed by a respondent in a divestiture order isued on October 24, 1984, had been placed on the public record for ten days and no comments had been received, the Commission reviewed the Request and concluded that the public interest warranted modifying Paragraph II(c) of the Order, so that the Agreement To Hold Separate, attached to the Order as Appendix I, "shall continue in effect until such time as Gulf's stock interest in Colonial Pipeline Company has been divested." The Commission held that the Hold Separate Agreement had accomplished its primary objectives with the divestitures of Gulf's refining and marketing assets in the Southeast and of its interest in Colonial Pipeline Company, and the potential harm resulting from the costs of continuing the Agreement outweighed any further need to maintain it in effect.

ORDER MODIFYING DECISION AND ORDER ISSUED OCTOBER 24, 1984

On February 21, 1985, respondent Chevron Corporation ("Chevron") filed a "Request For Termination Of Hold Separate Agreement" ("Request"). Since Paragraph II(c) of the decision and order issued on October 24, 1984 ("the order") incorporates the Agreement To Hold Separate, which is attached to the order as Appendix I, the Request, in effect, seeks modification of the order to terminate the Hold Separate Agreement. The Request was on the public record for ten days and no comments were received.

Paragraph II(c) of the order provides that the Agreement to Hold Separate "shall continue in effect until such time as the Schedule A Properties have been divested. . . ." As the Request notes, the Hold Separate Agreement is not limited to the assets that Chevron is required to divest pursuant to the order but is applicable to all of Gulf's domestic oil and gas assets and operations. Chevron has now submitted divestiture applications covering all of the assets it is required to divest and the Commission has approved the divestitures with the exception of the divestiture of 51 percent of Gulf's interest in the West Texas Pipeline Company. The latter divestiture proposal is awaiting Commission action.

After reviewing respondent's Request, the Commission has concluded that the public interest warrants reopening the order and modifying Paragraph II(c) so that the Hold Separate Agreement will terminate on the consummation of the divestiture of Gulf's interest in Colonial Pipeline Company. The Commission has concluded that the potential harm resulting from the costs of continuing the Hold Separate Agreement outweighs any further need to maintain it in effect. The Commission is of the opinion that, with the divestitures of Gulf's refining and marketing assets in the Southeast and of its interest in Colonial Pipeline Company, the Hold Separate Agreement has accomplished its primary objectives. On the other hand, Chevron has demonstrated that the continuation of the Hold Separate Agreement, which is applicable to all of Gulf's domestic oil and gas assets and operations, is imposing considerable costs on Chevron and Gulf. These costs have been estimated to exceed $1 million a day and are being incurred because the Hold Separate Agreement prevents the realization of efficiencies that are expected to flow from integrating the operations of the two companies. Such efficiencies include those that can be achieved in combining the Chevron and Gulf work forces; increasing operating efficiencies and eliminating the duplication of functions resulting from overlapping operations in various areas; and combining desirable aspects of the technologies of the two companies. Chevron has also demonstrated that the Hold Separate Agreement is contributing to the loss of a considerable number of skilled employees who are difficult to replace and is adversely affecting the morale and productivity of Gulf employees.

Accordingly, *it is ordered,* that this matter be, and it hereby is, reopened, and that Paragraph II(c) of the Commission's order issued on October 24, 1984, be, and it hereby is, modified to read as follows:

(c) The Agreement to Hold Separate, attached hereto and made a part hereof as Appendix I, shall continue in effect until such time as Gulf's stock interest in Colonial Pipeline Company has been divested, and Chevron and Gulf shall comply with all terms of said Agreement.

Commissioner Calvani voted in the negative.

IN THE MATTER OF

COMMODORE BUSINESS MACHINES, INC.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3151. Complaint, March 22, 1985–Decision, March 22, 1985

This Consent Order requires a West Chester, Pa. marketer of computer products, among other things, to cease, in connection with the advertising, sale or distribution of the Commodore 64 or any other hardware or software computer product, representing the availability or capability of a product, unless at the time of the claim the product is available for public sale in reasonable quantities, or has the claimed capability. The Order further bars the company from making any representations concerning the future availability or capability of a computer product unless the firm has a reasonable basis for the claim at the time the representation is made. Respondent is additionally required to maintain specified records for a period of three years.

Appearances

For the Commission: *Reid B. Horwitz* and *Joel Winston.*

For the respondent: *James R. Wendelgass,* in-house counsel, West Chester, Pa.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Commodore Business Machines, Inc. ("Commodore"), hereinafter at times referred to as respondent, has violated the provisions of the said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Commodore is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 1200 Wilson Drive, West Chester, Pennsylvania.

PAR. 2. Commodore has been and now is engaged in the business of manufacturing, advertising, offering for sale, sale and distribution of the Commodore 64 computer and other computer hardware and software products to the public.

PAR. 3. Among the products available as accessories for computers are microprocessors, which enable the computer to utilize different software operating systems. These operating systems allow the use of various software programs. One such operating system is CP/M, which enables the computer to process hundreds of software programs.

PAR. 4. The respondent, in connection with the marketing of computer products, has disseminated, and now disseminates, advertisements and promotional material for the purpose of promoting the sale of Commodore products.

PAR. 5. Respondent maintains, and has maintained, a substantial course of business, including the acts and practices set forth herein, in or affecting commerce, as commerce is defined in the Federal Trade Commission Act.

PAR. 6. Typical statements and representations in said advertisements and promotional materials, but not necessarily all-inclusive thereof, are found in advertisements attached hereto as Exhibits A - E.

PAR. 7. Through the use of the statements and representations referred to in Paragraph Six and others, respondent has represented, directly or by implication, that:

(a) The Z80 microprocessor, for use with the Commodore 64 computer, was generally available for sale to the public.

(b) The Commodore 64 computer could be equipped to use the CP/M operating system, and thereby process CP/M software, through purchase of the Z80 microprocessor.

PAR. 8. In truth and in fact:

(a) At the time of the dissemination of said statements and representations, the Z80 microprocessor for use with the Commodore 64 computer was not generally available for sale to the public.

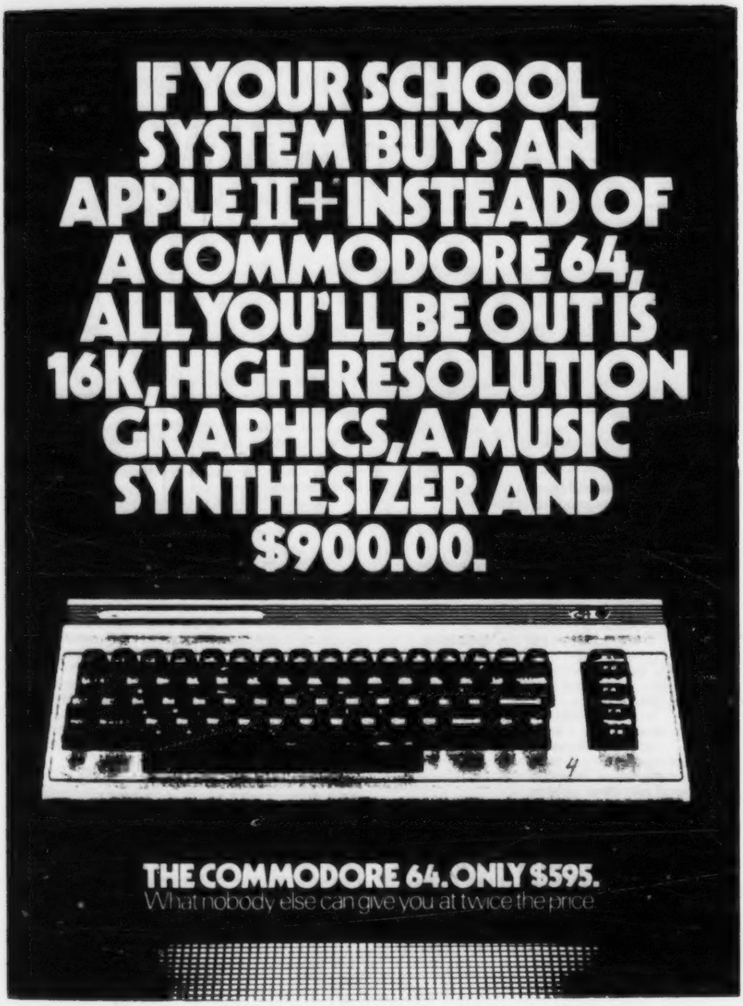
(b) At the time of the dissemination of said statements and representations, the Commodore 64 computer could not be equipped to use the CP/M operating system, and was therefore incapable of processing CP/M software, because the Z80 microprocessor was not generally available for sale to the public.

Therefore, the statements and representations referred to in Paragraphs Six and Seven were false, misleading and deceptive.

PAR. 9. The use by respondent of the aforesaid false, misleading and deceptive statements, representations, acts and practices, has had the capacity and tendency to mislead members of the public into the erroneous and mistaken belief that said statements and representations were true and complete, and into the purchase of substantial quantities of respondent's products by reason of said erroneous and mistaken belief.

PAR. 10. The acts and practices of respondent, as herein alleged, were and are all to the prejudice and injury of the public and of respondent's competitors and constituted, and now constitute, unfair and deceptive acts or practices in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act.

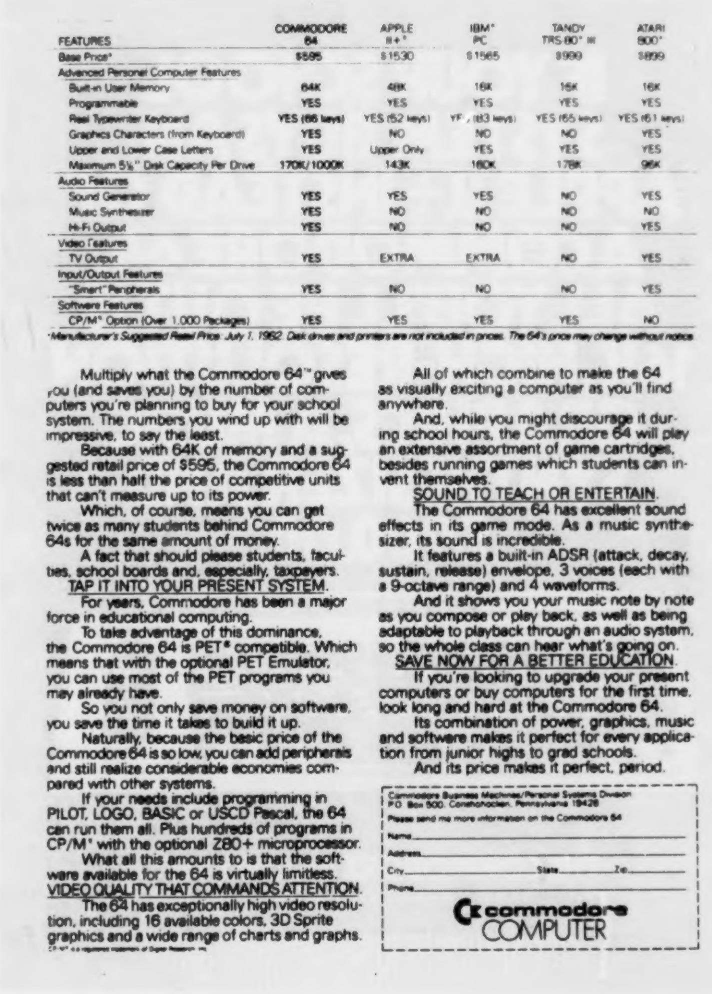
ATTACHMENT A



IF YOUR SCHOOL SYSTEM BUYS AN APPLE II+ INSTEAD OF A COMMODORE 64, ALL YOU'LL BE OUT IS 16K, HIGH-RESOLUTION GRAPHICS, A MUSIC SYNTHESIZER AND $900.00.

THE COMMODORE 64. ONLY $595.

What nobody else can give you at twice the price



FEATURES	COMMODORE 64	APPLE II+*	IBM* PC	TANDY TRS-80* III	ATARI 800*
Base Price*	$595	$1530	$1565	$999	$899
Advanced Personal Computer Features					
Built-in User Memory	64K	48K	16K	16K	16K
Programmable	YES	YES	YES	YES	YES
Real Typewriter Keyboard	YES (66 keys)	YES (52 keys)	YES (83 keys)	YES (65 keys)	YES (61 keys)
Graphics Characters (from Keyboard)	YES	NO	NO	NO	YES
Upper and Lower Case Letters	YES	Upper Only	YES	YES	YES
Maximum 5¼" Disk Capacity Per Drive	170K/1000K	143K	160K	178K	96K
Audio Features					
Sound Generator	YES	YES	YES	NO	YES
Music Synthesizer	YES	NO	NO	NO	NO
Hi-Fi Output	YES	NO	NO	NO	YES
Video Features					
TV Output	YES	EXTRA	EXTRA	NO	YES
Input/Output Features					
"Smart" Peripherals	YES	NO	NO	NO	YES
Software Features					
CP/M* Option (Over 1,000 Packages)	YES	YES	YES	YES	NO

*Manufacturer's Suggested Retail Price: July 1, 1982. Disk drives and printers are not included in prices. The 64's price may change without notice.

Multiply what the Commodore 64™ gives you (and saves you) by the number of computers you're planning to buy for your school system. The numbers you wind up with will be impressive, to say the least.

Because with 64K of memory and a suggested retail price of $595, the Commodore 64 is less than half the price of competitive units that can't measure up to its power.

Which, of course, means you can get twice as many students behind Commodore 64s for the same amount of money.

A fact that should please students, faculties, school boards and, especially, taxpayers.

TAP IT INTO YOUR PRESENT SYSTEM.

For years, Commodore has been a major force in educational computing.

To take advantage of this dominance, the Commodore 64 is PET® compatible. Which means that with the optional PET Emulator, you can use most of the PET programs you may already have.

So you not only save money on software, you save the time it takes to build it up.

Naturally, because the basic price of the Commodore 64 is so low, you can add peripherals and still realize considerable economies compared with other systems.

If your needs include programming in PILOT, LOGO, BASIC or USCD Pascal, the 64 can run them all. Plus hundreds of programs in CP/M* with the optional Z80+ microprocessor.

What all this amounts to is that the software available for the 64 is virtually limitless.

VIDEO QUALITY THAT COMMANDS ATTENTION.

The 64 has exceptionally high video resolution, including 16 available colors, 3D Sprite graphics and a wide range of charts and graphs.

All of which combine to make the 64 as visually exciting a computer as you'll find anywhere.

And, while you might discourage it during school hours, the Commodore 64 will play an extensive assortment of game cartridges, besides running games which students can invent themselves.

SOUND TO TEACH OR ENTERTAIN.

The Commodore 64 has excellent sound effects in its game mode. As a music synthesizer, its sound is incredible.

It features a built-in ADSR (attack, decay, sustain, release) envelope, 3 voices (each with a 9-octave range) and 4 waveforms.

And it shows you your music note by note as you compose or play back, as well as being adaptable to playback through an audio system, so the whole class can hear what's going on.

SAVE NOW FOR A BETTER EDUCATION.

If you're looking to upgrade your present computers or buy computers for the first time, look long and hard at the Commodore 64.

Its combination of power, graphics, music and software makes it perfect for every application from junior highs to grad schools.

And its price makes it perfect, period.

Commodore Business Machines/Personal Systems Division
P.O. Box 500, Conshohocken, Pennsylvania 19428

Please send me more information on the Commodore 64

Name____________________

Address____________________

City__________ State________ Zip________

Phone____________________

commodore
COMPUTER

CP/M* is a registered trademark of Digital Research, Inc.

ATTACHMENT B

"THE COMMODORE 64 COULD BE THE MICROCOMPUTER INDUSTRY'S OUTSTANDING NEW PRODUCT INTRODUCTION SINCE THE BIRTH OF THIS INDUSTRY."

-SHEARSON/AMERICAN EXPRESS

The Commodore 64™ to judge from the above comment, is generating as much excitement among the people who invest in companies as it is among the people who run them.

The reason for this is that, for the first time, high-level computer power is limited only by the inclination to have it, rather than the means.

HALF THE COST = TWICE THE PRODUCTIVITY.

This simple equation reflects the Commodore 64's most basic—and outstanding—qualifications.

Its standard memory is 64K. Which is unusual enough in a micro at any price.

At $595, it is astonishing.

Compared, for example, with the Apple II+,* the Commodore 64 offers 33% more power at considerably less than 50% of the price.

Compared with anything else, it's even more impressive.

And if you're a businessman, it can effectively double your computer-equipped work force.

PILE ON THE PERIPHERALS.

Because the basic cost of the Commodore 64 is so low, you can afford more peripherals for it. Like disk drives, printers and a telephone modem.

For about the price of an Apple II+ computer alone, you could equip your company with a Commodore 64, disk drive, printer and modem.

HARD FACTS ABOUT SOFTWARE

The Commodore 64 will be able to run virtually any program important to business and industry.

Commodore software will include an electronic spreadsheet, business graphics (including printout), a user-definable diary/calendar, word processing, mailing lists, an electronic mail program, and much more.

Even programs that can teach operators how to program.

It is programmable in BASIC.

With the added CP/M* option, you can have access to hundreds of existing software packages.

In short, its applications are virtually limitless.

THE FUN SIDE OF POWER

The Commodore 64 can become very playful at a moment's notice.

You can use it with Commodore's game cartridges or invent your own diversions. All will be enhanced by brilliant video quality and high resolution graphics (320 × 200 pixels, 16 available colors, 3D Sprite graphics), plus its own unique music synthesizer.

THE COMMODORE 64. ONLY $595.

NOW'S YOUR CHANCE.

If you've been waiting for the "computer revolution," consider it as having arrived.

Through its 25 years of existence, Commodore has been committed to delivering better products at lower prices.

Today, the company's vertical integration has resulted in the Commodore 64's price performance breakthrough heralded by Shearson/American Express.

So if you run a company, you couldn't make a more cost-efficient capital investment.

For more information, contact your local Commodore dealer, or send in this coupon.

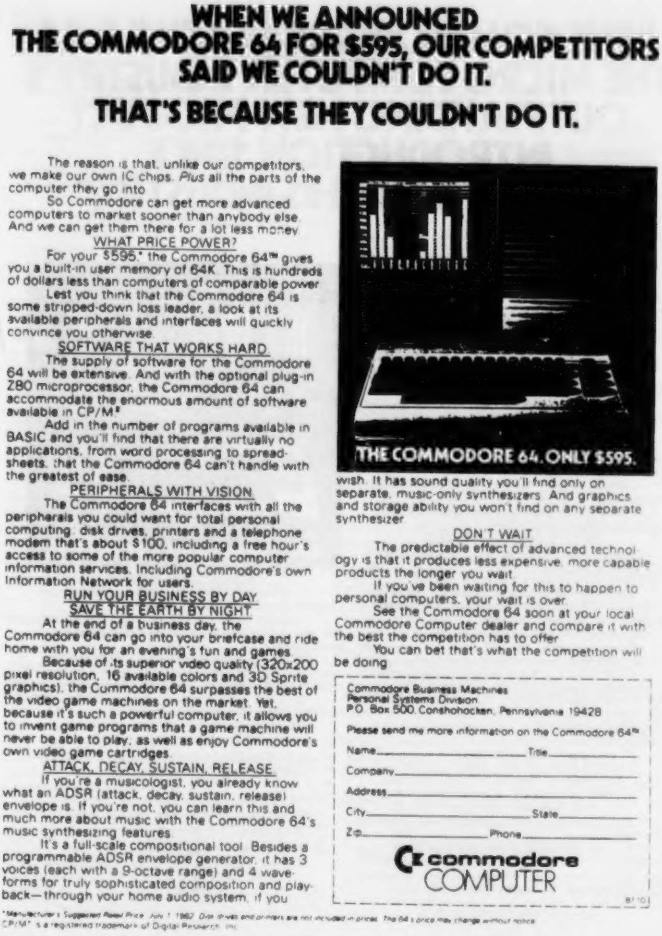
Commodore Business Machines, Personal Systems Division
P.O. Box 500, Conshohocken, Pennsylvania 19428

Please send me more information on the Commodore 64

Name
Title Company
Address
City State
Zip Telephone

commodore
COMPUTER

ATTACHMENT C



WHEN WE ANNOUNCED THE COMMODORE 64 FOR $595, OUR COMPETITORS SAID WE COULDN'T DO IT.

THAT'S BECAUSE THEY COULDN'T DO IT.

The reason is that, unlike our competitors, we make our own IC chips. *Plus* all the parts of the computer they go into.

So Commodore can get more advanced computers to market sooner than anybody else. And we can get them there for a lot less money.

WHAT PRICE POWER?

For your $595,* the Commodore 64™ gives you a built-in user memory of 64K. This is hundreds of dollars less than computers of comparable power.

Lest you think that the Commodore 64 is some stripped-down loss leader, a look at its available peripherals and interfaces will quickly convince you otherwise.

SOFTWARE THAT WORKS HARD

The supply of software for the Commodore 64 will be extensive. And with the optional plug-in Z80 microprocessor, the Commodore 64 can accommodate the enormous amount of software available in CP/M.®

Add in the number of programs available in BASIC and you'll find that there are virtually no applications, from word processing to spreadsheets, that the Commodore 64 can't handle with the greatest of ease.

PERIPHERALS WITH VISION

The Commodore 64 interfaces with all the peripherals you could want for total personal computing: disk drives, printers and a telephone modem that's about $100, including a free hour's access to some of the more popular computer information services. Including Commodore's own Information Network for users.

RUN YOUR BUSINESS BY DAY
SAVE THE EARTH BY NIGHT

At the end of a business day, the Commodore 64 can go into your briefcase and ride home with you for an evening's fun and games.

Because of its superior video quality (320x200 pixel resolution, 16 available colors and 3D Sprite graphics), the Commodore 64 surpasses the best of the video game machines on the market. Yet, because it's such a powerful computer, it allows you to invent game programs that a game machine will never be able to play, as well as enjoy Commodore's own video game cartridges.

ATTACK, DECAY, SUSTAIN, RELEASE

If you're a musicologist, you already know what an ADSR (attack, decay, sustain, release) envelope is. If you're not, you can learn this and much more about music with the Commodore 64's music synthesizing features.

It's a full-scale compositional tool. Besides a programmable ADSR envelope generator, it has 3 voices (each with a 9-octave range) and 4 waveforms for truly sophisticated composition and playback—through your home audio system, if you wish. It has sound quality you'll find only on separate, music-only synthesizers. And graphics and storage ability you won't find on any separate synthesizer.

THE COMMODORE 64. ONLY $595.

DON'T WAIT

The predictable effect of advanced technology is that it produces less expensive, more capable products the longer you wait.

If you've been waiting for this to happen to personal computers, your wait is over.

See the Commodore 64 soon at your local Commodore Computer dealer and compare it with the best the competition has to offer.

You can bet that's what the competition will be doing.

Commodore Business Machines
Personal Systems Division
P.O. Box 500, Conshohocken, Pennsylvania 19428

Please send me more information on the Commodore 64™

Name ______________________ Title ______________

Company ______________________________________

Address ______________________________________

City ______________________ State ______________

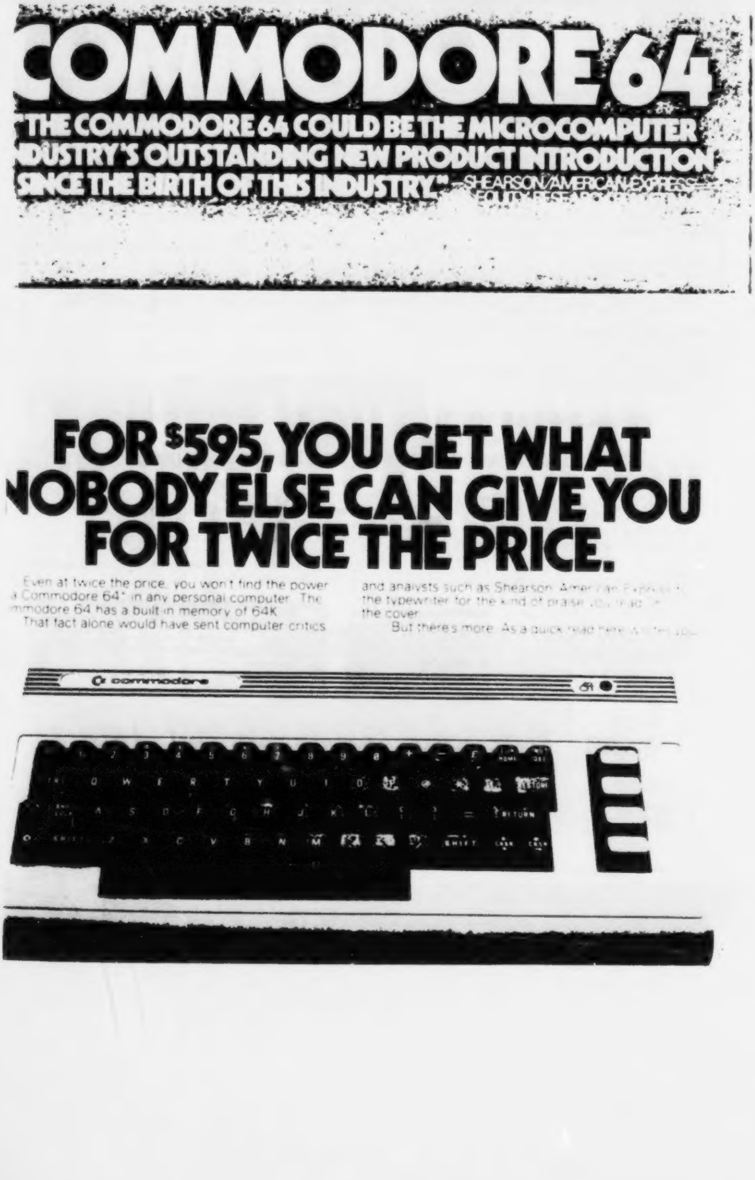
Zip ______________________ Phone ______________

commodore
COMPUTER

81 10

*Manufacturer's Suggested Retail Price, July 1, 1982. Disk drives and printers are not included in prices. The 64's price may change without notice.
CP/M® is a registered trademark of Digital Research, Inc.

ATTACHMENT D



COMMODORE 64

"THE COMMODORE 64 COULD BE THE MICROCOMPUTER
NDUSTRY'S OUTSTANDING NEW PRODUCT INTRODUCTION
SINCE THE BIRTH OF THIS INDUSTRY." —SHEARSON/AMERICAN EXPRESS
EQUITY RESEARCH [illegible]

FOR $595, YOU GET WHAT NOBODY ELSE CAN GIVE YOU FOR TWICE THE PRICE.

Even at twice the price, you won't find the power a Commodore 64* in any personal computer. The mmodore 64 has a built-in memory of 64K.

That fact alone would have sent computer critics and analysts such as Shearson American Express [illegible] the typewriter for the kind of praise you read [illegible] the cover.

But there's more. As a quick read here [illegible]

2 of 3

THE 64, QUITE SIMPLY, HAS NO COMPETITION. AS A QUICK LOOK AT OUR COMPETITION WILL TELL YOU.

Features	COMMODORE 64	APPLE II+*	IBM* PC	TANDY TRS 80* III	ATARI 800*
Base Price*	$595	$1530	$1565	$999	$899
Advanced Personal Computer Features					
Built-in User Memory	64K	48K	16K	16K	48K
Programmable	Yes	Yes	Yes	Yes	Yes
Real Typewriter Keyboard	Yes (66 keys)	Yes (52 keys)	Yes (83 keys)	Yes (65 keys)	Yes (61 keys)
Graphics Characters (from Keyboard)	Yes	No	No	No	Yes
Upper and Lower Case Letters	Yes	Upper Only	Yes	Yes	Yes
5¼" Disk Capacity Per Drive	170K	143K	160K	178K	96K
Audio Features					
Sound Generator	Yes	Yes	Yes	No	Yes
Music Synthesizer	Yes	No	No	No	No
Hi-Fi Output	Yes	No	No	No	Yes
Video Features					
TV Output	Yes	Extra	Extra	No	Yes
Input/Output Features					
"Smart" Peripherals	Yes	No	No	No	Yes
oftware Features					
P/M* Option (Over 1,000 Packages)	Yes	Yes	Yes	Yes	No
Game Machine Features					
Cartridge Game Slot	Yes	No	No	No	Yes
Game Controllers	Yes	Yes	Yes	No	Yes

Manufacturer's Suggested Retail Price July 1, 1982 Disk drives and printers are not included in prices
The 64's price may change without notice. And after they get a look at the chart you can count on the competition to change their prices

WITH A COMPUTER THAT'S LIGHT YEARS AHEAD OF ITS COMPETITION, WE THOUGHT IT APPROPRIATE THAT ITS SOFTWARE SHOULD BE AT LEAST A FEW YEARS AHEAD.

Here's how we did it

PART I THE FIRST ORDERLY APPROACH TO SOFTWARE

Commodore's programmers examined the whole gle of software available today—literally hundreds of grams—and isolated the most popular and nost useful

Then they made them better The result a variety of ighly refined, perfected programs or home, business and education

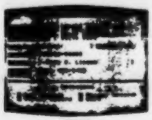
PART II AN ALMOST INFINITE ARRAY OF SOFTWARE

Independent makers of software ave already hopped on the 64 bandwagon They've come to Commodore or training on the 64 and are adapting the world's most popular programs to the 64

Further, the 64 is compatible with CP/M* Which means a simple optional add on opens up over 2,000 additional useful programs

Plus—and a big plus this is for educators—you can also have access to programs developed for the Commodore PET* as it uses the same BASIC language as the Commodore 64

WORD PROCESSING


DATA BASE

ELECTRONIC SPREADSHEET

WHY DID THE 64 COME FROM COMMODORE AND NOT SOMEBODY ELSE? BECAUSE WE MAKE OUR OWN CHIPS.

Commodore is one of the few companies that esign and manufacture their own chips

So, unlike other computer companies that have o buy their chips, when Commodore wants to alter a design or create a new one, their designers and engineers work hand in hand

The result a lot more computer for a lot less money

OH, BY THE WAY, THE 64 JUST SO HAPPENS TO BE THE MOST BRILLIANT GAME MACHINE YOU CAN BUY.

JUPITER LANDER

With the 64, not only will you have an amazing array of terrific games (just a few are pictured here), but what's really amazing is how you'll see them.

With a variety of colors that's never been offered before, with a full range of sound, and with a resolution that truly rivals arcades.

Since the 64 is a true computer, you can actually invent your own sophisticated (or unsophisticated) games.

WHAT DOES THE COMMODORE 64 DO? WHAT DO YOU WANT IT TO DO?

Whether you're in business and want a personal computer for spreadsheet calculation or word and text processing or mailing lists or data storage and retrieval.

Or whether you're a musician looking for a music synthesizer (or a beginner who wants to learn how to play one).

The 64, quite simply, can do almost anything you want it to. And all with graphics that have an incredible resolution.

FOR ABOUT $100 EXTRA, THE COMMODORE 64 CAN GET INFORMATION AND PROGRAMS FROM MULTI-MILLION DOLLAR COMPUTERS.

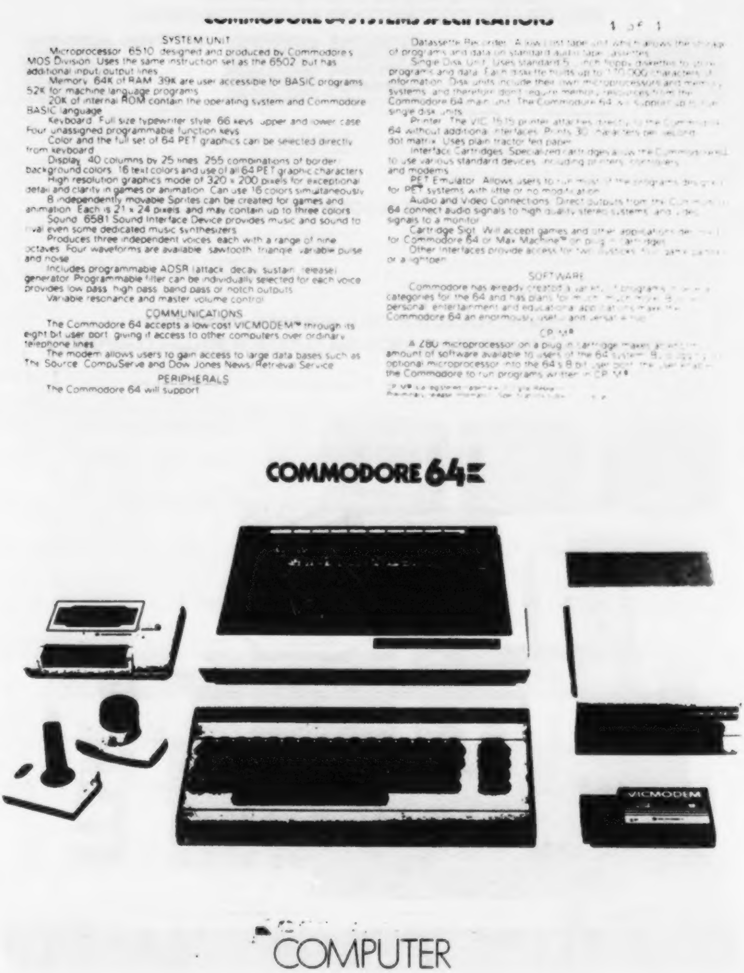
A modem is a device that connects your computer to your phone.

Telecomputing, they call it. They used to also call it expensive. A personal computer and modem would go for at least $1,500 and be judged "reasonable."

What happens when, for less than half that figure, the Commodore 64 hooks up with your telephone?

Just about anything such as stock quotes, news updates, electronic mail and computer shopping — to name a few. In addition, Commodore has its own information network accessible through CompuServe*

VICMODEM
commodore
64



COMMODORE 64 SYSTEMS SPECIFICATIONS 1 of 1

SYSTEM UNIT

Microprocessor 6510 designed and produced by Commodore's MOS Division. Uses the same instruction set as the 6502 but has additional input/output lines

Memory 64K of RAM 39K are user accessible for BASIC programs 52K for machine language programs

20K of internal ROM contain the operating system and Commodore BASIC language

Keyboard Full size typewriter style 66 keys upper and lower case Four unassigned programmable function keys

Color and the full set of 64 PET graphics can be selected directly from keyboard

Display 40 columns by 25 lines 255 combinations of border/background colors 16 text colors and use of all 64 PET graphic characters

High resolution graphics mode of 320 x 200 pixels for exceptional detail and clarity in games or animation Can use 16 colors simultaneously

8 independently movable Sprites can be created for games and animation Each is 21 x 24 pixels and may contain up to three colors

Sound 6581 Sound Interface Device provides music and sound to rival even some dedicated music synthesizers

Produces three independent voices each with a range of nine octaves Four waveforms are available sawtooth triangle variable pulse and noise

Includes programmable ADSR (attack decay sustain release) generator Programmable filter can be individually selected for each voice provides low pass high pass band pass or notch outputs

Variable resonance and master volume control

COMMUNICATIONS

The Commodore 64 accepts a low cost VICMODEM™ through its eight bit user port giving it access to other computers over ordinary telephone lines

The modem allows users to gain access to large data bases such as The Source CompuServe and Dow Jones News/Retrieval Service

PERIPHERALS

The Commodore 64 will support

Datassette Recorder A low cost tape unit which allows the storage of programs and data on standard audio tape cassettes

Single Disk Unit Uses standard 5¼ inch floppy diskettes to store programs and data Each diskette holds up to 170,000 characters of information Disk units include their own microprocessors and memory systems and therefore don't require memory resources from the Commodore 64 main unit The Commodore 64 will support up to four single disk units

Printer The VIC 1515 printer attaches directly to the Commodore 64 without additional interfaces Prints 30 characters per second dot matrix Uses plain tractor fed paper

Interface Cartridges Specialized cartridges allow the Commodore 64 to use various standard devices including printers controllers and modems

PET Emulator Allows users to run most of the programs designed for PET systems with little or no modification

Audio and Video Connections Direct outputs from the Commodore 64 connect audio signals to high quality stereo systems and video signals to a monitor

Cartridge Slot Will accept games and other applications designed for Commodore 64 or Max Machine™ on plug in cartridges

Other interfaces provide access for two joysticks four game paddles or a lightpen

SOFTWARE

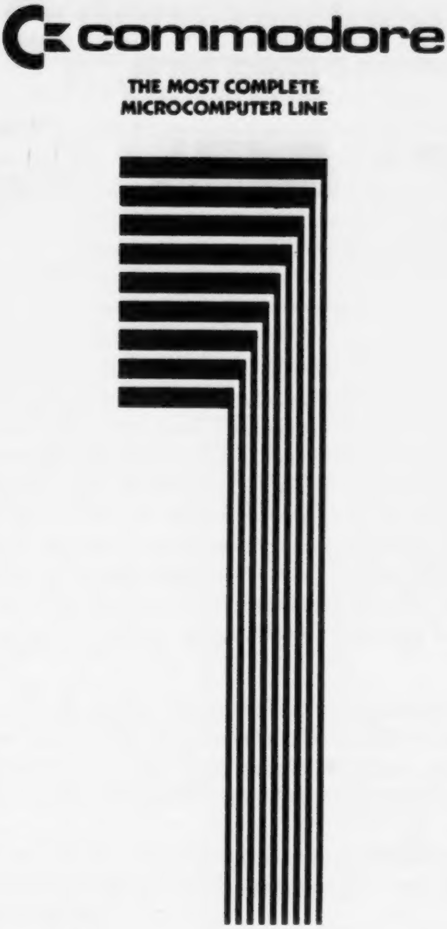
Commodore has already created a variety of programs in several categories for the 64 and has plans for much much more Business personal entertainment and educational applications make the Commodore 64 an enormously useful and versatile tool

CP/M®

A Z80 microprocessor on a plug in cartridge makes [illegible] amount of software available to users of the 64 system By plugging the optional microprocessor into the 64's 8 bit user port the user enables the Commodore to run programs written in CP/M®

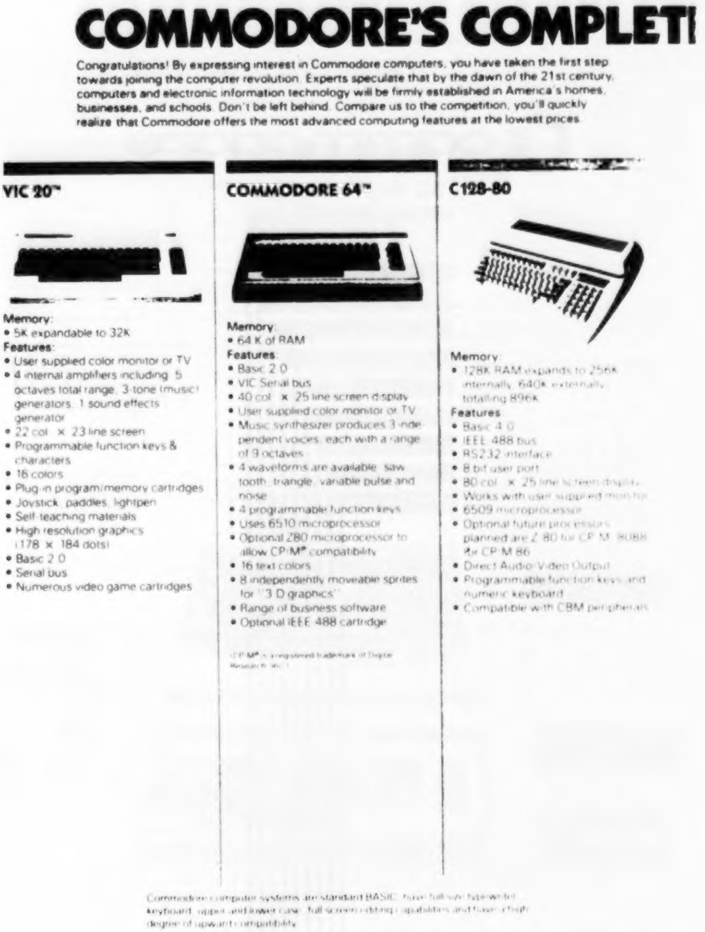
CP/M® is a registered trademark of Digital Research [illegible]
[illegible]

ATTACHMENT E



commodore

THE MOST COMPLETE
MICROCOMPUTER LINE



COMMODORE'S COMPLETI

Congratulations! By expressing interest in Commodore computers, you have taken the first step towards joining the computer revolution. Experts speculate that by the dawn of the 21st century, computers and electronic information technology will be firmly established in America's homes, businesses, and schools. Don't be left behind. Compare us to the competition, you'll quickly realize that Commodore offers the most advanced computing features at the lowest prices.

VIC 20™

Memory:
- 5K expandable to 32K

Features:
- User supplied color monitor or TV
- 4 internal amplifiers including: 5 octaves total range, 3-tone (music) generators, 1 sound effects generator
- 22 col. × 23 line screen
- Programmable function keys & characters
- 16 colors
- Plug-in program/memory cartridges
- Joystick, paddles, lightpen
- Self-teaching materials
- High resolution graphics (178 × 184 dots)
- Basic 2.0
- Serial bus
- Numerous video game cartridges

COMMODORE 64™

Memory:
- 64 K of RAM

Features:
- Basic 2.0
- VIC Serial bus
- 40 col. × 25 line screen display
- User supplied color monitor or TV
- Music synthesizer produces 3 independent voices, each with a range of 9 octaves
- 4 waveforms are available: saw tooth, triangle, variable pulse and noise
- 4 programmable function keys
- Uses 6510 microprocessor
- Optional Z80 microprocessor to allow CP/M® compatibility
- 16 text colors
- 8 independently moveable sprites for "3 D graphics"
- Range of business software
- Optional IEEE 488 cartridge

(CP/M® is a registered trademark of Digital Research, Inc.)

C128-80

Memory:
- 128K RAM expands to 256K internally, 640K externally, totalling 896K

Features:
- Basic 4.0
- IEEE 488 bus
- RS232 interface
- 8 bit user port
- 80 col. × 25 line screen display
- Works with user supplied monitor
- 6509 microprocessor
- Optional future processors planned are Z 80 for CP/M, 8088 for CP/M 86
- Direct Audio/Video Output
- Programmable function keys and numeric keyboard
- Compatible with CBM peripherals

Commodore computer systems are standard BASIC, have full-size typewriter keyboard, upper and lower case, full screen editing capabilities and have a high degree of upward compatibility.

DECISION AND ORDER

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondents with violation of the Federal Trade Commission Act; and

The respondent, its attorney, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondent has violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, and having duly considered the comments filed thereafter by interested persons pursuant to Section 2.34 of its Rules, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Commodore Business Machines, Inc. is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 1200 Wilson Drive, in the City of West Chester, State of Pennsylvania.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

ORDER

This order shall not apply to representations made by respondent exclusively outside the United States and its possessions and territories.

I

It is ordered, That respondent Commodore Business Machines, Inc., a corporation, its successors and assigns, and its officers, agents, representatives, and employees, directly or through any corporation, subsidiary, division or other device, in connection with the manufacture, advertising, offering for sale, sale, or distribution of the Commodore 64 computer, or any other computer hardware or software product, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from representing, directly or by implication:

a. That any such product is available for sale to the public or has any capability, unless at the time such representation is made such product is then available for sale in reasonable quantities to the public or has said capability.

b. That any such product will be available for sale to the public or will have any capability, unless at the time of such representation respondent possesses and relies upon a reasonable basis for said representation.

II

It is further ordered, That respondent or its successors or assigns maintain accurate records of all materials that were relied upon by respondent in disseminating any representation covered by this order.

Such record shall be retained by respondent or its successors or assigns for three (3) years from the date that the representations to which they pertain are last disseminated. It is further ordered that any such records shall be retained by respondent or its successors or assigns and that respondent or its successors or assigns shall make such documents available to the Commission for inspection and copying upon request.

III

It is further ordered, That respondent notify the Commission at least thirty (30) days prior to any proposed change in respondent such as dissolution, assignment, or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporation which may affect compliance obligations arising out of the order.

IV

It is further ordered, That respondent shall forthwith distribute a copy of this order to each of its operating divisions.

V

It is further ordered, That respondent shall, within sixty (60) days after service of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which it has complied with this order.

IN THE MATTER OF

LURIA BROTHERS AND COMPANY, INC., ET AL.

SET ASIDE ORDER IN REGARD TO ALLEGED VIOLATION OF THE FEDERAL TRADE COMMISSION ACT AND SEC. 7 OF THE CLAYTON ACT

Docket 6156. Order, Feb. 13, 1963—Set Aside Order, March 28, 1985

In response to a petition filed by Luria Brothers and Company, Inc. ("Luria"), the Commission, on February 1, 1985, reopened the proceedings in Docket No. 6156 and set aside the order issued on February 13, 1963, 65 F.T.C. 243, as it applied to Luria, on ground that it no longer served any procompetitive purpose and may impede the company's ability to compete effectively for the business of scrap consumers that desire exclusive supply arrangements. [105 F.T.C. 192] However, the commission determined that this action would only provide partial relief as long as the corresponding prohibitions against the purchasers of iron and steel scrap remained in effect. It therefore issued to respondent mills still in operation, orders to show cause why the proceedings in Docket 6156 should not be reopened to set aside Paragraph 2(a), which prohibited the mills from purchasing scrap exclusively from Luria, and giving the firm preferential treatment as a broker or supplier of scrap. Having received no objections to the proposed action, the Commission has reopened the proceeding and set aside Paragraph 2(a) holding that in view of its set aside order as it applied to Luria, setting aside Paragraph 2(a) of the 1963 order is in the public interest.

ORDER SETTING ASIDE PARAGRAPH 2(a) OF THE ORDER ISSUED FEBRUARY 13, 1963

In response to a petition filed by Luria Brothers and Company, Inc. ("Luria"), the Federal Trade Commission on February 1, 1985, reopened the proceedings in Docket No. 6156 and set aside the order as it applied to respondent Luria. [105 F.T.C. 192] In doing so, the commission concluded that the order no longer serves any procompetitive purpose and that it may impede unnecessarily Luria's ability to compete effectively for the business of scrap consumers that desire exclusive supply arrangements. However, the Commission believes that setting aside the order as to Luria alone would provide only partial relief as long as order Paragraph 2(a)'s corresponding prohibitions against scrap purchasers remain in effect. Paragraph 2(a) prohibits the respondent mills from purchasing all or almost all of any plant's requirement of scrap iron and steel from Luria, and from giving Luria preferential status or favored treatment as a broker or supplier of iron and steel scrap.

On February 1, 1985, the Commission, pursuant to Section 3.72 of its Rules of Practice and Procedure, 16 C.F.R. 3.72, issued to the spondent mills still in operation[1] orders to show cause why the proceedings in Docket No. 6156 should not be reopened to set aside Paragraph 2(a) of the order. Respondent milis were provided an opportunity to object to the proposed action, and having failed to do so, are now deemed to have consented to such action. In view of the Commission's set aside of the order as it applied to Luria, the Commission believes that the set aside of Paragraph 2(a) of the order, barring the respondent mills from using Luria as their exclusive scrap broker or supplier, is in the public interest.

Accordingly,

It is hereby ordered, That this matter be, and it hereby is, reopened and that Paragraph 2(a) of the order shall be set aside as of the effective date of this order.

Commissioner Bailey concurs in result.

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[1] The Commission issued show cause orders to the following respondent mills: Bethlehem Steel Corporation; United States Steel Corporation; Phoenix Steel Corporation; Empire-Detroit Steel Division, Cyclops Corporation; ITT Grinnell Corporation; Standard Steel Division, Titanium Metals Corporation; McLouth Steel Corporation; Edgewater Corporation; Bucyrus-Erie Company; Weirton Steel Corporation; CF & I Steel Corporation and National Steel Corporation. Respondent mill formerly known as the Granite City Steel Company is now a division of the National Steel Corporation.

IN THE MATTER OF

THE AMERICAN ACADEMY OF ORTHOPAEDIC SURGEONS

MODIFYING ORDER IN REGARD TO ALLEGED VIOLATION OF THE FEDERAL TRADE COMMISSION ACT

Docket C-2856. Consent Order, Dec. 14, 1976—Modifying Order, March 29, 1985

In response to a petition filed by the American Academy of Orthopaedic Surgeons ("AAOS"), this Order reopens the matter of Docket C-2856, and modifies the consent order entered against AAOS, 88 F.T.C. 968, by deleting Paragraph II(B) of the Order which bars the organization from advising in favor of or against any relative value scale developed by third parties, and inserting a provision identical to one contained in the FTC's order in *Michigan State Medical Society (Michigan State)*, Docket No. 9129, 101 F.T.C. 191, that permits AAOS more freedom to discuss reimbursement issues with third-party payers and governmental entities. The Commission noted that it had recently modified a similar order entered against the American College of Obstetricians and Gynecologists ("ACOG"), Docket No. C-2855, [104 F.T.C. 524 (1984)] after finding that the benefits derived from its restriction on ACOG's ability to discuss relative value scales with third-party payers and governmental entities were outweighed by the resulting injury to ACOG and the public, and that finding was applicable to AAOS. Accordingly, the Commission has modified the AAOS order in the same manner as it modified the ACOG order, and that modification is also consistent with the Commission's decision in *Michigan State*.

ORDER REOPENING AND MODIFYING FINAL ORDER

By petition filed November 19, 1984, the American Academy of Orthopaedic Surgeons ("AAOS") asked the Commission to reopen and modify the Commission order in Docket No. C-2856 entered by consent against AAOS on December 14, 1976 ("Order") [88 F.T.C. 968]. AAOS requested that the Commission modify the Order by a) deleting Paragraph II(B) of the Order, which prohibits AAOS from advising in favor of or against any relative value scale developed by third parties (except that AAOS is permitted to provide historical data), and b) inserting a provision identical to a provision contained in the Commission's Order in *Michigan State Medical Society*, Docket No. 9129, 101 F.T.C. 191 (1983) *("Michigan State")* that would allow AAOS more freedom to discuss issues relating to reimbursement with third-party payers and governmental entities. AAOS's petition was placed on the public record and no comments were received.

Upon consideration of AAOS's petition and other relevant information, the Commission finds that the public interest would be served by deleting Paragraph II(B) of the Order and by inserting the relevant provision contained in the order in *Michigan State*. The Commission's order against the American College of Obstetricians and Gynecologists ("ACOG") in Docket No. C-2855 is similar to the *AAOS* order, and the Commission recently reopened and modified the *ACOG* order, finding that its restriction on ACOG's ability to discuss relative value scales with third-party payers and governmental entities had caused injury to ACOG and the public that outweighed any benefit that might be derived from the restriction. [104 F.T.C. 524 (1984)] AAOS's petition is based on ACOG's petition and the Commission has determined that its finding in ACOG is applicable to AAOS. Accordingly, the Commission has modified the *AAOS* order in the same manner as it modified the *ACOG* order. The modification is also consistent with the Commission's decision in *Michigan State.*

The Order continues to prohibit AAOS from developing and circulating its own relative value guide for use by its members. In addition, although the Order no longer will prohibit AAOS from discussing relative value scales with governmental entities and third-party payers, serious antitrust concerns would arise were AAOS to negotiate or attempt to negotiate an agreement with any such party or engage in any type of coercive activity to effect such an agreement.

Accordingly,

It is ordered, That this matter be, and it hereby is, reopened and that the Order in Docket No. C-2856 be modified 1) to delete Paragraph II(B) and to redesignate Paragraphs II(C) and II(D) of the Order Paragraphs II(B) and II(C) respectively; 2) to renumber Paragraphs III, IV and V of the Order Paragraphs IV, V and VI respectively; and 3) to insert the following:

III.

It is further ordered, That this order shall not be construed to prevent AAOS from:

A. Exercising rights permitted under the First Amendment to the United States Constitution to petition any federal or state government, executive agency, or legislative body concerning legislation, rules or procedures, or to participate in any federal or state administrative or judicial proceeding.

B. Providing information or views, on its own behalf or on behalf of its members, to third-party payers concerning any issue, including reimbursement.

IN THE MATTER OF

WARD CORPORATION, ET AL.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket 9160. Complaint, March 9, 1982—Decision, April 5, 1985

This Consent Order, among other things, requires five Rockville, Maryland builders and sellers of residential housing, together with a corporation officer, to cease failing to fully honor valid warranty claims within a reasonable period of time; representing that materials are defect-free, unless defects due to faulty material, workmanship or design are corrected or remedied within a reasonable period of time; failing to provide purchasers with building lots substantially conforming to the physical characteristics represented by the sellers; and failing to disclose, prior to the signing of a sales contract, all disclaimers or limitations of the firms' responsibilities with regard to the physical condition of the lot. The text of all written warranties must be clearly and conspicuously displayed in sales offices and model homes, and a copy of such warranties must be provided to prospective buyers if requested. In addition, the firms are required to provide future purchasers with an opportunity to arbitrate warranty disputes; provide arbitration to homeowners who had purchased their homes in the year preceding the effective date of the order; and, subject to conditions set forth in the order, provide repairs and/or payments to qualified homeowners who had purchased their homes between March 10, 1978 and a date one year prior to the effective date of the order, and who still own these homes.

Appearances

For the Commission: *Miriam Daniels, Louise R. Jung, Karen Egbert, Anne Maher* and *Richard C. Donahue.*

For the respondents: *Mitchell S. Cutler* and *Michael E. Kris, Finley, Kumble, Wagner, Heine, Undedberg & Casey,* Washington, D.C. and *Robert A. Skitol, Steven K. Yablonski* and *Jane Seigler, Wald, Harkrader & Ross,* Washington, D.C.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, as amended, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that respondents Ward Corporation, R.E. Ward, Inc., Ward Development Company, Inc., Ward Component Systems, Inc., Richlynn Development, Inc., Richlynn Land Developers, Inc., corporations, and Richard E. Ward, individually and as an officer of said corporations, hereinafter sometimes referred to as respondents, have violated the provisions of said

Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint, stating its charges in that respect as follows:

I. RESPONDENTS

PARAGRAPH 1. Respondent Ward Corporation is a corporation organized, existing and doing business under and by virtue of the laws of the State of Maryland, with its office and principal place of business located at 1300 Piccard Drive, Rockville, Maryland.

Respondents R.E. Ward Inc., Ward Development Company, Inc., and Ward Component Systems, Inc., are wholly-owned subsidiaries of respondent Ward Corporation, and are corporations organized, existing and doing business under and by virtue of the laws of the State of Maryland, with their office and principal place of business located at 1300 Piccard Drive, Rockville, Maryland.

Respondents Richlynn Development, Inc. and Richlynn Land Developers, Inc., are wholly-owned subsidiaries of respondent Ward Corporation, and are corporations organized, existing and doing business under and by virtue of the laws of the State of Virginia, with their office and principal place of business located at 1300 Piccard Drive, Rockville, Maryland.

Respondent Richard E. Ward is an individual and is the principal officer and director of the corporate respondents. He formulates, directs and controls the acts and practices of the corporate respondents, including the acts and practices hereinafter set forth. His business address is the same as that of the corporate respondents.

II. NATURE OF TRADE AND BUSINESS

PAR. 2. Respondents are now, and for some time past have been, engaged in: the construction of housing; the manufacture of pre-fabricated components and component systems, lumber products and other building materials for use in housing; the development of land on a finished lot basis; the improvement, repair or modification of housing; the advertising, offering for sale and/or sale of the above-mentioned property, goods or services to the public; and other like or similar activities.

III. JURISDICTION

PAR. 3. In the course and conduct of their business, respondents cause, and for some time past have caused, their property, goods and services to be offered for sale and sold in Maryland, Virginia and other States to purchasers and prospective purchasers located in Maryland, Virginia and various other States of the United States and the District of Columbia by means of advertisements placed in newspapers of interstate circulation.

Respondent Ward Corporation provides, and for some time past has provided, its subsidiary companies incorporated and doing business in Maryland and Virginia with administrative, financial and accounting services, and in-house data processing facilities.

Respondent R.E. Ward, Inc., subcontracts, and for some time past has subcontracted, its housing construction services to its affiliates in Maryland and Virginia.

Respondents Ward Development Company, Inc., and Richlynn Development, Inc., are now, and for some time past have been, engaged in the offering for sale and sale of housing to purchasers and prospective purchasers residing in various States of the United States and the District of Columbia.

Respondent Ward Component Systems, Inc., is now, and for some time past has been, engaged in the manufacture, sale, and distribution of building components and materials from its plants in Maryland, Virginia and Delaware to customers located in various States of the United States and the District of Columbia.

Respondent Richlynn Land Developers, Inc., is now, and for some time past has been, engaged in the development of land in various States in the United States.

In addition, respondents cause, and for some time past have caused, their advertising material, contracts, and various business papers to be transmitted by means of the United States mail from their places of business in Maryland and Virginia to purchasers and potential purchasers in various other States of the United States and the District of Columbia. Respondents maintain, and at all times mentioned herein have maintained, a substantial course of trade in said property, goods and services in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended.

IV. ACTS AND PRACTICES: WARRANTIES

PAR. 4. In the further course and conduct of their aforesaid business, respondents are now and have been, directly or implicitly, granting or disseminating certain warranties to purchasers of their aforesaid homes.

1. Respondents are now and have been disseminating a written warranty to purchasers of their aforesaid homes, under which warranty respondents warrant that they will correct (a) any defects due to faulty construction and/or defective materials, (b) specific defects including roof leaks, basement leaks, inadequate heating or air conditioning systems, excess settlement of finish grade, and (c) any patent

defects noted at the time of final inspection, where such defects are reported to respondents before the end of one year from the date of possession or settlement, whichever occurs first.

2. Respondents are now and have been since approximately July 1, 1976, by force of Maryland State law, warranting for a period of one year to purchasers of their aforesaid homes located in Maryland that at the time the home is completed it is (a) free from faulty materials, (b) constructed according to sound engineering standards and in a workmanlike manner, and (c) fit for habitation, except that these warranties do not apply to any condition that an inspection of the premises would reveal to a reasonably diligent purchaser at the time the contract is signed.

3. Respondents are now and have been since approximately July 1, 1979, by force of Virginia State law, warranting for a period of one year to purchasers of their aforesaid homes located in Virginia that the home, at the time of transfer of record title or the purchaser's taking possession, whichever occurs first, is (a) sufficiently free from structural defects, so as to pass without objection in the trade, (b) constructed in a workmanlike manner, so as to pass without objection in the trade, and (c) fit for habitation.

PAR. 5. By and through the granting and dissemination of such warranties, respondents have represented, directly or implicitly, that:

1. Respondents will correct, in a workmanlike manner, all defects within the scope of the written warranty disseminated to purchasers, and will complete these tasks within a reasonable time after they receive notice of the defects.

2. Respondents will correct, in a workmanlike manner, all defects within the scope of the warranties implied under Maryland State law, and will complete these tasks within a reasonable time after they receive notice of the defects.

3. Respondents will correct, in a workmanlike manner, all defects within the scope of the warranties implied under Virginia State law, and will complete these tasks within a reasonable time after they receive notice of the defects.

PAR. 6. In truth and in fact, respondents have not fully performed their obligations under their written warranty and warranties implied under Maryland and Virginia State law.

1. In numerous instances, respondents have failed to correct, in a workmanlike manner, defects within the scope of their written warranty and/or warranties implied under Maryland or Virginia State law. Typical and illustrative of the uncorrected defects, but not all inclusive thereof, are:

a. Excessive vibration, sloping and/or sagging of floors, caused in part by the faulty construction of floor support systems;

b. Uneven and inadequate heating of rooms, caused in part by the use of undersized heat pumps, faulty installation of heating ducts and omission of insulation;

c. Basement water leakage through walls, window wells and doors, caused in part by the faulty installation of components, poor site grading and inadequate waterproofing;

d. Roof leaks, caused in part by the lack of building paper underneath the roofing shingles;

e. Excessive air and water infiltration in window areas, caused in part by the faulty installation, poor fit and/or poor design of windows and window frames;

f. Excessive cracking and settling of stoops, caused in part by the lack of a proper base under the stoops;

g. Excessive cracking and settling of driveways, caused in part by the improper application of the asphalt material and/or inadequate preparation of the underlying surface;

2. In numerous instances, where respondents, in a workmanlike manner, have corrected defects within the scope of the written warranty and/or warranties implied under State law, purchasers have encountered delays frequently exceeding six months from the time respondents received notice of the defect to the time respondents corrected the defect.

Therefore, the statements, representations, acts and practices relating to respondents' written warranty, as alleged in Paragraphs Four (1.) and Five (1.) were and are deceptive.

PAR. 7. Furthermore, respondents' failure to perform their obligations fully pursuant to their written warranty and warranties implied under State law has resulted in substantial injury to consumers. Therefore, the acts and practices as alleged in Paragraphs Four, Five, and Six were and are unfair.

PAR. 8. Furthermore, respondents continued to grant or disseminate said warranties to purchasers of their aforesaid homes even though respondents knew or should have known of their failure to perform warranty obligations fully with respect to past purchasers' homes. Under these circumstances, reasonably prudent businesspersons would have known that the acts and practices as alleged in Paragraphs Four, Five and Six were dishonest or fraudulent. Furthermore, such acts and practices have resulted in substantial injury to respondents' purchasers for which a court may grant relief pursuant to Section 19(b) of the Federal Trade Commission Act, as amended.

PAR. 9. In the further course of their business, respondents are now and have been, since October 1, 1979, including a clause in their

"Agreement of Sale" whereby purchasers agree to accept respondents' written warranty "in lieu of all other warranties whatsoever, whether express or implied."

PAR. 10. By and through the inclusion of the aforesaid clause in the "Agreement of Sale," respondents have represented, directly or implicitly, that purchasers have only those warranty rights provided by respondents and no other warranty rights, whether express or implied under State law.

PAR. 11. In truth and in fact, the aforesaid clause is clearly inapplicable, ineffective, invalid and/or unenforceable under Maryland and Virginia State law. Therefore, the inclusion of this clause has the tendency or capacity to deceive or mislead purchasers as to their warranty rights and was and is unfair or deceptive.

V. OTHER ACTS AND PRACTICES

PAR. 12. In the further course and conduct of their aforesaid business, respondents are now and have been providing purchasers with an opportunity to inspect their homes prior to settlement while accompanied by respondents' representative and to have all readily apparent defects or incomplete items listed on an "Orientation Inspection" sheet provided by respondents. In the further course and conduct of their business, respondents have represented, directly or implicitly, orally or in writing, that they will correct or complete, in a workmanlike manner, as many items listed as possible prior to settlement, and/or will correct or complete, in a workmanlike manner, all items listed within a reasonable time after the pre-settlement inspection.

PAR. 13. In truth and in fact, respondents have not fully performed their obligations with respect to items listed by purchasers during the pre-settlement inspection.

1. In numerous instances, respondents have failed to correct, in a workmanlike manner, defects listed. Typical and illustrative of the uncorrected defects, but not all inclusive thereof are the following: floor vibration; basement leaks; erosion of dirt under stoops; deterioration of driveways; damaged siding; poorly fitting storm windows; missing or loose roof shingles.

2. In numerous instances, respondents have failed to complete, in a workmanlike manner, all incomplete items listed. Typical and illustrative of the incomplete items, but not all inclusive thereof, are the following: missing insulation; lack of grass coverage of the lot; presence of rocks and construction debris in the soil; unfinished and inadequate lot grading.

3. In numerous instances, where respondents, in a workmanlike

manner, have corrected or completed items listed, purchasers have encountered long delays frequently exceeding six months from the time of the pre-settlement inspection to the time respondents corrected or completed the item.

Therefore, the statements, representations, acts and practices as alleged in Paragraph Twelve were and are deceptive.

PAR. 14. Furthermore, respondents' failure to perform their obligations fully with respect to items listed by purchasers during the pre-settlement inspection has resulted in substantial injury to consumers. Therefore, the acts and practices as alleged in Paragraphs Twelve and Thirteen were and are unfair.

PAR. 15. Furthermore, respondents continued to engage in the acts and practices alleged in Paragraph Twelve even though respondents knew or should have known of their failure to perform obligations fully with respect to items listed during the pre-settlement inspection by past purchasers of their aforesaid homes. Under these circumstances, reasonably prudent businesspersons would have known that the acts and practices as alleged in Paragraphs Twelve and Thirteen were dishonest or fraudulent. Furthermore, such acts and practices have resulted in substantial injury to respondents' purchasers for which a court may grant relief pursuant to Section 19(b) of the Federal Trade Commission Act, as amended.

PAR. 16. In the further course and conduct of their aforesaid business, and for the purpose of inducing the public to purchase respondents' homes, respondents are now and have been including pictorial representations and written statements in their advertising brochures, sales documents and advertising inserted in newspapers of interstate circulation.

Typical and illustrative of said pictorial representations are Exhibits A, B, C, and D, attached hereto.

Typical and illustrative of said written statements are the following:

STANDARD FEATURES: Attractive Landscaping

STANDARD FEATURES: Landscaping includes seeding and shrubs.

You'll find split level and 2 story homes on beautiful lots all over a full acre.

An inviting community of traditional homes on beautiful ½ acre lots.

The homes are surrounded by beautifully landscaped shade trees . . .

Furthermore, respondents have built model homes which are open to the public. These homes are located on level lots which are fully grass-covered and landscaped.

PAR. 17. By and through the use of model homes and the representations and statements described in Paragraph Sixteen, and others of similar import and meaning not expressly set out therein, respondents have represented, directly or implicitly, that:

1. Respondents will grade, in a workmanlike manner, the lots sold to purchasers of their homes.
2. Respondents will remove rocks and construction debris from the lots.
3. Respondents will provide sufficient topsoil so that purchasers can reasonably maintain landscaping on the lots.
4. Respondents will adequately protect trees on the lots during the construction process.

PAR. 18. In truth and in fact, respondents have not finished lots as represented.

1. In numerous instances, respondents have failed to grade lots in a workmanlike manner.

a. In numerous instances, respondents have failed to fill in ruts, depressions and holes created on the lots during the construction process.

b. In numerous instances, respondents have failed to provide adequate drainage on the lot, resulting in the presence of standing water over long periods of time and large muddy areas on the lots.

c. In numerous instances, respondents have left steep inclines on the lots.

2. In numerous instances, respondents have failed to remove substantial amounts of rocks and construction debris from the lots.

3. In numerous instances, respondents have failed to provide sufficient topsoil, resulting in the purchasers' inability to reasonably maintain the landscaping on the lots.

4. In numerous instances, respondents have failed to protect adequately trees on the lots during the construction process, resulting in the destruction of the trees.

Therefore, the representations, statements, acts and practices as alleged in Paragraphs Sixteen and Seventeen were and are deceptive.

PAR. 19. Furthermore, respondents' failure to finish lots as represented to purchasers has resulted in substantial injury to consumers. Therefore, the acts and practices as alleged in Paragraphs Sixteen, Seventeen and Eighteen were and are unfair.

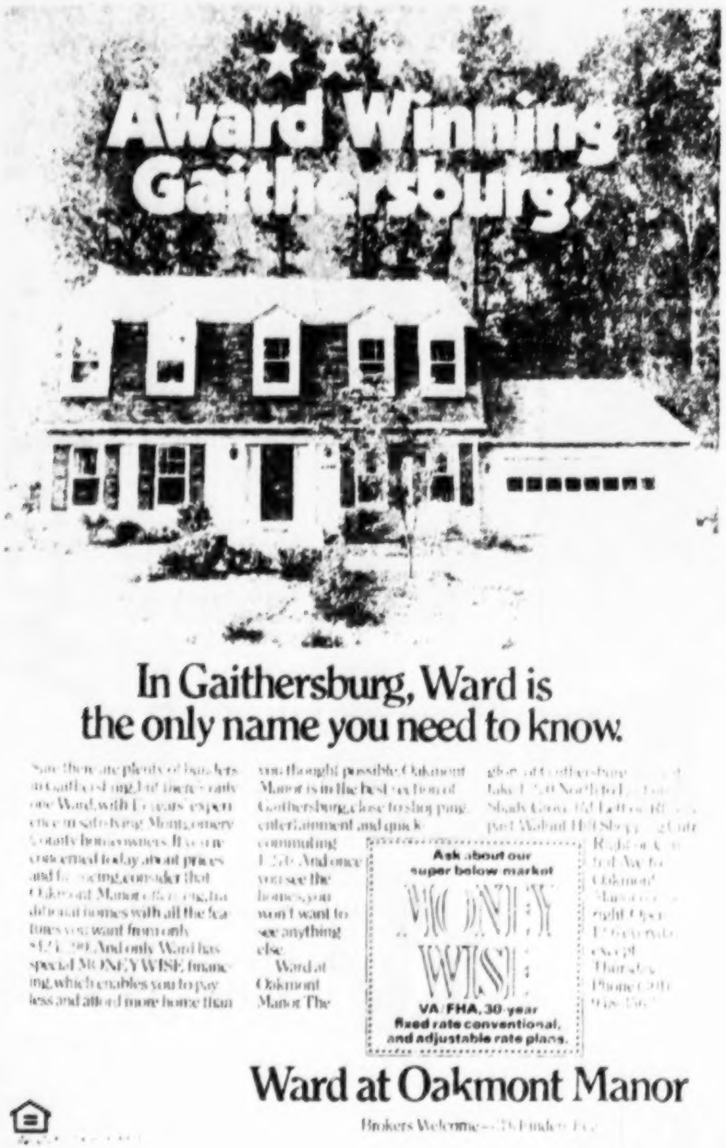
PAR. 20. Furthermore, respondents continued to engage in the acts and practices alleged in Paragraphs Sixteen and Seventeen even though respondents knew or should have known of their failure to finish lots as represented to past purchasers of their aforesaid homes. Under these circumstances, reasonably prudent businesspersons would have known that the acts and practices as alleged in Paragraphs Sixteen, Seventeen and Eighteen were dishonest or fraudulent. Furthermore, such acts and practices have resulted in substantial injury to respondents' purchasers for which a court may grant relief pursuant to Section 19(b) of the Federal Trade Commission Act, as amended.

PAR. 21. In the course and conduct of their aforesaid business, and at all times mentioned herein, respondents have been, and now are, in substantial competition in or affecting commerce with corporations, firms, and individuals engaged in the sale and construction of residential housing.

PAR. 22. The use by respondents of the aforesaid unfair, false, misleading, or deceptive statements, representations, acts, and practices has had, and now has, the capacity and tendency to mislead members of the public into the erroneous and mistaken belief that said statements and representations were, and are, true and complete, or into the purchase of substantial numbers of respondents' houses by reason of said erroneous and mistaken belief.

PAR. 23. The aforesaid acts and practices of respondents, as herein alleged, were, and, are, all to the prejudice and injury of the public and of respondents' competitors, and constituted, and now constitute unfair or deceptive acts or practices in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, as amended. Although respondents, in some of their sales contracts, provide for binding arbitration of disputes "arising under and pursuant to this Contract, or in any way related to the house and lot to be conveyed," purchasers could not have reasonably avoided injury resulting from respondents' alleged unfair acts or practices. The availability of arbitration was not referred to in conjunction with respondents' presettlement or warranty procedures and was not raised by respondents at the time any dispute arose between respondents and purchasers or at the time any lawsuit was filed by a purchaser against respondents. Furthermore, many other sales contracts used by respondents did not provide for arbitration of disputes. For these and other reasons, the presence of the arbitration provision in some of respondents' sales contracts does not excuse respondents from liability for the unfair acts or practices alleged herein. The acts and practices of respondents, as herein alleged, are continuing, and will continue, in the absence of the relief herein requested.

EXHIBIT A



In Gaithersburg, Ward is the only name you need to know.

Sure there are plenty of builders in Gaithersburg. But there's only one Ward, with [illegible] years' experience in satisfying Montgomery County homeowners. If you're concerned today about prices and financing, consider that Oakmont Manor offers [illegible] different homes with all the features you want from only $[illegible]. And only Ward has special MONEYWISE financing, which enables you to pay less and afford more home than you thought possible. Oakmont Manor is in the best section of Gaithersburg, close to shopping, entertainment and quick commuting [illegible]. And once you see the homes, you won't want to see anything else.

Ward at Oakmont Manor. The [illegible] Gaithersburg [illegible] North to [illegible] Shady Grove [illegible] Left [illegible] past Walnut Hill Shopping Center. Right on [illegible] to Oakmont Manor [illegible] right. Open [illegible] except Thursday. Phone (301) [illegible]

Ask about our super below market

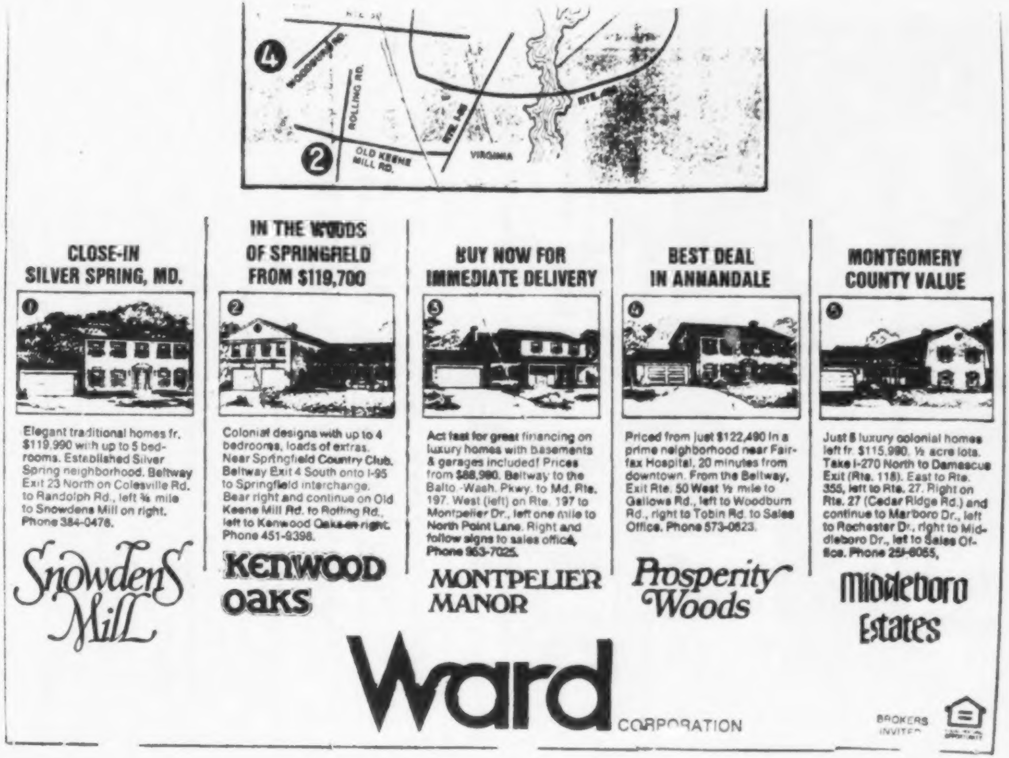
MONEY WISE

VA/FHA, 30-year fixed rate conventional, and adjustable rate plans.

Ward at Oakmont Manor

Brokers Welcome — [illegible]

EXHIBIT B


④
②
ROLLING RD.
OLD KEENE MILL RD.
VIRGINIA
①
②
③
④
⑤
BROKERS INVITED

CLOSE-IN SILVER SPRING, MD.

Elegant traditional homes fr. $119,990 with up to 5 bedrooms. Established Silver Spring neighborhood. Beltway Exit 23 North on Colesville Rd. to Randolph Rd., left ⅜ mile to Snowdens Mill on right. Phone 384-0476.

Snowdens Mill

IN THE WOODS OF SPRINGFIELD FROM $119,700

Colonial designs with up to 4 bedrooms, loads of extras. Near Springfield Country Club. Beltway Exit 4 South onto I-95 to Springfield interchange. Bear right and continue on Old Keene Mill Rd. to Rolling Rd., left to Kenwood Oaks on right. Phone 451-9398.

KENWOOD OAKS

BUY NOW FOR IMMEDIATE DELIVERY

Act fast for great financing on luxury homes with basements & garages included! Prices from $88,980. Beltway to the Balto.-Wash. Pkwy. to Md. Rte. 197. West (left) on Rte. 197 to Montpelier Dr., left one mile to North Point Lane. Right and follow signs to sales office, Phone 953-7025.

MONTPELIER MANOR

BEST DEAL IN ANNANDALE

Priced from just $122,490 in a prime neighborhood near Fairfax Hospital, 20 minutes from downtown. From the Beltway, Exit Rte. 50 West ½ mile to Gallows Rd., left to Woodburn Rd., right to Tobin Rd. to Sales Office. Phone 573-0823.

Prosperity Woods

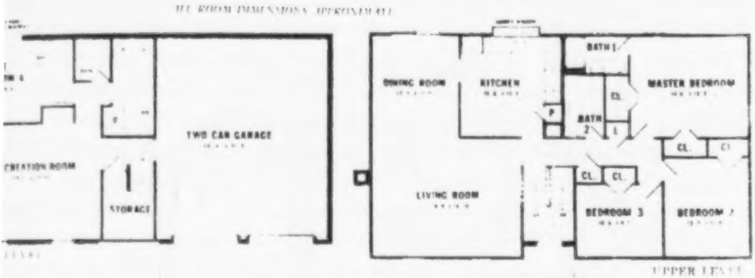
MONTGOMERY COUNTY VALUE

Just 8 luxury colonial homes left fr. $115,990. ½ acre lots. Take I-270 North to Damascus Exit (Rte. 118). East to Rte. 355, left to Rte. 27. Right on Rte. 27 (Cedar Ridge Rd.) and continue to Marboro Dr., left to Rochester Dr., right to Middleboro Dr., left to Sales Office. Phone 251-6065,

Middleboro Estates

Ward CORPORATION

EXHIBIT C

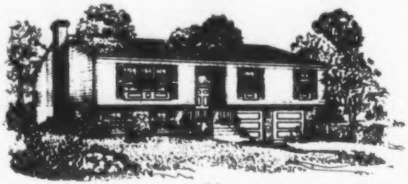

ALL ROOM DIMENSIONS APPROXIMATE
M 4
CREATION ROOM
STORAGE
TWO CAR GARAGE
LEVEL
DINING ROOM
KITCHEN
BATH 1
MASTER BEDROOM
CL.
P
BATH 2
L
CL.
CL.
CL.
CL.
LIVING ROOM
BEDROOM 3
BEDROOM 2
UPPER LEVEL

Note: Legal restrictions limit 4th bedroom in type [illegible] homes with walk-out basements only

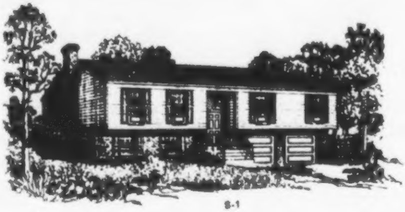
The Sycamore

SPLIT FOYER

An exciting flair for good living begins in the dramatic, two-story split-foyer entry. Upstairs, a large formal living room, separate dining room, an eat-in kitchen boasting the very latest appliances and, over the sink, a sunny garden window with shelving for your plants. The sleeping wing includes a master suite with its own bath, 2 additional bedrooms and a complete hall bath. On the lower level, a tremendous recreation room with an included fireplace, space for a 4th bedroom and optional bath, ample household storage, and a two-car garage. Air conditioning and carpeting are included. Energy-conservation package includes heat pump and thermal insulation for year-round fuel savings.

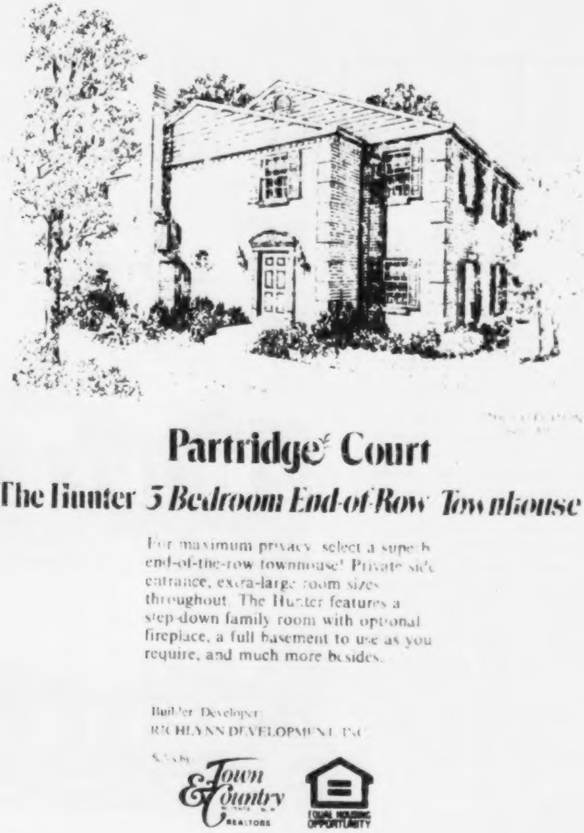


S-2



S-1

EXHIBIT D



Partridge Court

The Hunter *3 Bedroom End-of-Row Townhouse*

For maximum privacy, select a superb end-of-the-row townhouse! Private side entrance, extra-large room sizes throughout. The Hunter features a step-down family room with optional fireplace, a full basement to use as you require, and much more besides.

Builder Developer:
RICHLYNN DEVELOPMENT, INC.

Sales by:

Town & Country
REALTORS
EQUAL HOUSING OPPORTUNITY

DECISION AND ORDER

The Commission having theretofore issued its complaint charging the respondents named in the caption hereof with violation of Section 5 of the Federal Trade Commission Act, as amended, and the respondents having been served with a copy of that complaint, together with a notice of contemplated relief; and

The respondents, their attorney, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondents of all the jurisdictional facts set forth in the complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondents that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Secretary of the Commission having thereafter withdrawn this matter from adjudication in accordance with section 3.25(c) of its Rules; and

The Commission having considered the matter and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, and having duly considered the comments filed thereafter by interested persons pursuant to section 3.25 of its Rules, now in conformance with the procedure prescribed in section 3.25(f) of its Rules, the Commission hereby makes the following jurisdictional findings and enters the following order:

1. Respondents Ward Corporation, Ward Development Company, Inc., and Ward Component Systems, Inc., are corporations organized, existing and doing business under and by virtue of the laws of the State of Maryland, with their principal place of business located at 1300 Piccard Drive, in the City of Rockville, State of Maryland.

2. Respondents Richlynn Development, Inc., and Richlynn Land Developers, Inc., are corporations organized, existing and doing business under and by virtue of the State of Virginia, with their principal place of business located at 1300 Piccard Drive, in the City of Rockville, State of Maryland.

3. Respondent Richard E. Ward is an officer of each said corporate respondent, and his principal place of business is located at 1300 Piccard Drive, in the City of Rockville, State of Maryland.

4. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondents, and the proceeding is in the public interest.

ORDER

I.

It is ordered, That respondents Ward Corporation, Ward Development Company, Inc., Ward Component Systems, Inc., Richlynn Development, Inc., and Richlynn Land Developers, Inc., corporations, and respondent Richard E. Ward, individually and as an officer of the corporations, their successors and assigns, and respondents' officers, agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the construction, advertising, offering for sale, or sale of any new single-family unit which is a detached structure, an attached or semi-attached townhouse unit or a twin unit (hereinafter referred to as "residential home") in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, do forthwith cease and desist from:

1. Representing, directly or by implication, that respondents will correct, repair or otherwise remedy any defect due to faulty materials, workmanship or design unless respondents do, in fact, correct, repair or otherwise remedy such defect within a reasonable period of time after receipt of a homeowner's valid request to do so.

2. Representing, directly or by implication, that the materials, workmanship or design is defect-free or meets or will meet a specified level of performance, unless the representation is, in fact, true or, in the event of any defect or a failure to meet the specified level of performance, respondents do, in fact, correct, repair or otherwise remedy such defect within a reasonable period of time after receipt of a homeowner's valid request to do so.

3. Failing to honor fully every valid warranty claim within a reasonable period of time after receipt of a homeowner's request therefor; *provided, however,* that nothing herein shall be construed as precluding respondents from denying or contesting a warranty claim believed in reasonable good faith to be without merit or, in such cases, from invoking any other rights provided by law.

4. Failing, whenever respondents represent, directly or by implication, that the lot offered to a purchaser will have certain physical characteristics including, but not limited to, size, contours, drainage, soil preparation, and seeding, to provide the purchaser with a lot conforming substantially to such representation.

5. Failing, prior to the time a sales contract for a new residential home is signed, to disclose clearly and conspicuously in writing to the

prospective purchaser all disclaimers or limitations of respondents' responsibilities with regard to the physical condition of the lot.

II.

It is further ordered, That respondents, in connection with the sale of any new residential home settled after the home is completed, do forthwith cease and desist from representing, directly or by implication, that respondents will correct or complete items listed on an "Orientation Inspection Sheet" or any similar document reflecting the results of the purchaser's pre-settlement inspection of the home, unless respondents:

(a) prior to settlement, inspect the home with the purchaser and any accompanying person(s), including (if desired) an inspector chosen by the purchaser, and list every readily apparent problem or incomplete item on an Orientation Inspection Sheet or similarly designated document;

(b) correct or complete all such listed problems or items within one hundred and twenty (120) days of the inspection, subject to *force majeure,* labor disruptions, or any other events reasonably beyond respondents' control, in which case respondents shall correct or complete such problems or items within a reasonable period of time; and

(c) disclose to the purchaser clearly and conspicuously on a copy of the Orientation Inspection Sheet or similarly designated document provided to the purchaser that, subject to events reasonably beyond respondents' control, all listed problems or items will be corrected or completed within one hundred and twenty (120) days.

III.

It is further ordered, That, in connection with any offering for sale of any new residential home for which a written warranty is offered, respondents shall:

1. Clearly and conspicuously display in each sales office and in each model home:

(a) The text of the warranty.

(b) A notice, in plain and readily understood language, that copies of the warranty may be obtained free of charge upon request.

2. Provide a copy of the warranty to each prospective purchaser who requests one.

3. Furnish to each purchaser a copy of the warranty prior to or at the time of execution of the sales contract for a new home.

4. Disclose clearly and conspicuously within the warranty any limitations on, disclaimers of, or exclusions from coverage under the written warranty or any implied warranty arising under state law; *provided, however,* that respondents shall not make any representation, written or oral, concerning any such limitation, disclaimer or exclusion where such limitation, disclaimer or exclusion is prohibited by state or federal law.

IV.

It is further ordered, That, in connection with each sale of a new residential home for which a written warranty is offered, respondents shall establish and abide by an informal dispute resolution procedure as described in Appendix A. Respondents shall furnish to each purchaser of such a home a copy of Appendix A or a comparable written explanation of said informal dispute resolution procedure prior to, or at the time of, execution of the sales contract for the new home; *provided, however,* that nothing herein shall prohibit respondents from utilizing a form of sales contract which clearly and conspicuously discloses that the homeowner agrees to invoke the aforementioned dispute resolution procedure prior to invoking any other remedy provided by law.

V.

It is further ordered, That, if respondents deny any written request for warranty work under respondents' written warranty, respondents shall, within thirty (30) days after receipt of the request, provide the homeowner with a written statement of reasons for the denial, together with notice of the homeowner's right to submit any such warranty dispute to the informal dispute resolution procedure provided for in Paragraph IV of this Order.

VI.

It is further ordered, That, in connection with any offering for sale of a new residential home for which no written warranty is offered, respondents shall, prior to the time of execution of the sales contract, disclose clearly and conspicuously in writing to the prospective purchaser the fact that no written warranty is offered and any limitations on, disclaimers of, and exclusions from any implied warranty arising under state law; *provided, however,* that respondents shall not make any representation, written or oral, concerning any such limitation, disclaimer or exclusion where such limitation, disclaimer or exclusion is prohibited by state or federal law.

VII.

It is further ordered, That, for each homeowner who took title to a home from respondents from March 10, 1978, to one year prior to the date of service of this Order and who as of the date of service of this Order is still the owner of that home, respondents shall establish and abide by the redress procedure and dispute resolution mechanism described in Appendix B for any claim made by the homeowner under any written warranty or under any express or implied warranty arising from state law and for any claim made by the homeowner relating to the pre-settlement inspection of the home, *provided* that:

1. In the case of a warranty claim, the homeowner made a claim to respondents during the first year after settlement, and there is credible written evidence in respondents' or the homeowner's possession to establish that such a claim was then made;
2. In the case of a claim relating to the pre-settlement inspection, the homeowner or respondents had at the time listed the problem or item on the Orientation Inspection Sheet;
3. The claim relating to a specific problem or item has a value of $500 or more, measured by the greater of the homeowner's actual out-of-pocket expenses reasonably incurred or the reasonable estimated cost of repair by a contractor. (All problems or items resulting from the same cause and involving the same component(s) or defect(s) shall be deemed to be a single problem or item for purposes of determining value. For example, a number of leaking windows in a home caused by improper installation of the windows shall be deemed to be a single problem or item.);
4. Respondents refused or otherwise failed adequately to satisfy the homeowner's claim; and
5. In the case of a home in which the homeowner has modified the affected part in a manner that substantially increases the cost of repairing or correcting the alleged problem or item but the homeowner nonetheless establishes that the alleged problem or item existed prior to the modification, respondents shall not be required to bear the increase in cost of repair or correction resulting from the modification.

VIII.

It is further ordered, That, for each homeowner who took title to a home from respondents within one year prior to the date of service of this Order and who as of the date of service of this Order is still the owner of the home, respondents shall establish and abide by an informal dispute resolution procedure substantially similar to that described in Appendix A for any claim made by the homeowner under any written warranty or under any express or implied warranty arising from state law and for any claim made by the homeowner relating to the presettlement inspection of the home and that within sixty (60) days after this Order becomes final, respondents shall provide each such homeowner with the notice letter attached hereto as Appendix C, along with a copy of Appendix A, or a comparable written explanation of said informal dispute resolution procedure.

IX.

It is further ordered, That in connection with any sale of a new residential home respondents shall maintain for three years after the date of transfer of title or of delivery of the home to the purchaser, whichever is earlier, and upon reasonable notice make available to the Commission for inspection and copying all non-privileged correspondence, memoranda and other documents regarding complaints or requests for repairs made to respondents by the purchasers, including all documents relating to repairs made by respondents to the home and all documents relating to disputes handled under the informal dispute resolution procedures required by this Order.

X.

It is further ordered, That respondents shall notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondents, such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporations which may affect compliance obligations arising out of this Order.

XI.

It is further ordered, That respondents shall, within thirty (30) days of the date of service of this Order, distribute a copy of this Order to (a) each of respondents' operating subsidiaries and divisions, and (b) each officer and salaried employee of respondents and of said subsidiaries and divisions engaged in the construction, advertising, offering for sale, or sale of any new residential home(s).

XII.

It is further ordered, That within six (6) months after the date of service of this Order and within six (6) months after the completion of all of respondents' obligations pursuant to paragraph VII of this Order, respondents shall file with the Commission a report, in writing, setting forth in detail the manner in which they have complied with this Order.

XIII.

It is further ordered, That all provisions of this Order except Subparagraphs 1, 2, 3 and 4 of Paragraph I shall be vacated ten (10) years after the date of service of this Order.

XIV.

It is further ordered, That no provision of this Order shall apply to any person, partnership, corporation or other entity not named herein unless respondents, individually or collectively, either have (a) a majority equity position in, (b) actual working control over, or (c) management responsibility for such person, partnership, corporation or other entity.

APPENDIX A

The informal dispute resolution procedure required by Paragraph IV of this Order shall be available to homeowners for an initiation fee of no more than $75.00 during the first three years after the effective date of this Order provision, no more than $100.00 during the fourth through sixth years after the effective date of this Order provision, and no more than $125.00 during the remaining years that this Order provision remains in effect. *Provided, however,* That in no event shall the initiation fee constitute more than half of the total cost of the procedure. Respondents shall be ordered to return or reimburse any such fee as part of the decision at the end of the procedure if the homeowner's claim is determined to be meritorious.

Upon invocation of this procedure by a homeowner, respondents shall appoint an arbitrator who is independent and knowledgeable in home construction and who has been either selected by an independent third-party organization experienced in dispute resolution or approved, in writing, by the homeowner. In ruling on claims submitted to him/her for resolution, the arbitrator shall (a) be bound by the provisions of respondents' written warranty and any express or implied warranties arising from state law and (b) use the Home Owners Warranty Program Quality Standards which are applicable to the first year of ownership of the home and any applicable provisions of the building code in the jurisdiction in which the home is located to interpret all applicable warranty provisions. He/she may also consider any applicable Orientation Inspection Sheet or similar document relating to an applicable pre-settlement inspection.

The arbitrator shall render a written decision on all claims submitted for resolution within sixty (60) days of respondents' receipt of the initiation fee, and shall promptly provide a copy of his/her decision to the homeowner and respondents. (If the homeowner is required under the sales contract to pursue this procedure prior to invoking any other legal remedy, he/she will be deemed to have fulfilled that requirement if a decision is not rendered within the required sixty-day period.) Such decisions shall be limited to determinations of the existence of defects or other problems within the scope of respondents' obligations, the nature of and time within which respondents should make required repairs or corrections, and, if the submitted claim is determined to be meritorious, return or reimbursement of the homeowner's initiation fee. The arbitrator's decision on each submitted claim shall be binding on respondents but not on the homeowner.

APPENDIX B

The procedure for redress under Paragraph VII of the Order shall include the following:

A. Within sixty (60) days after the Order becomes final, respondents shall provide each homeowner covered by paragraph VII with the attached documents and a detailed description of the dispute resolution mechanism and its possible uses.

B. Within sixty (60) days after the mailing date of respondents' notice to the homeowner of his/her right to file claims for redress, the homeowner shall mail his/her claim to respondents or forfeit any right to repairs or reimbursement under this Order.

C. Within sixty (60) days after receipt of any claim for redress, respondents shall respond in writing to the homeowner by either:

1) Offering, within a stated time, to correct or repair the problem or item or to pay the homeowner an amount of money in settlement of the claim, and at the same time informing the homeowner of his/her right to accept or reject the offer, along with notice that:

a) If a homeowner accepts the offer, he/she has the right to submit any dispute over respondents' performance under the offer to the dispute resolution mechanism; and

b) If a homeowner rejects the offer, he/she has the right to submit the disputed claim to the dispute resolution mechanism.

2) Denying the claim and at the same time giving the homeowner a detailed explanation of the reasons for the denial, along with notice that the homeowner has the right to submit the denied claim to the dispute resolution mechanism.

D. If a homeowner accepts the offered remedy, respondents shall perform the remedy within the time promised.

E. The dispute resolution mechanism shall:

1) Be available to homeowners for an initiation fee of no more than $75.00. *Provided, however,* That in no event shall the initiation fee constitute more than half of the total cost of the procedure.

2) Use an arbitrator who is independent and knowledgeable in home construction and who has been either selected by an independent third-party organization experienced in dispute resolution or approved, in writing, by the homeowner. In decisions relating to warranty claims, he/she shall be bound by the provisions of the written warranty and warranties implied under state law. The arbitrator shall use the Home Owners Warranty Program Quality Standards which are applicable to the first year

of ownership of the home and any applicable provisions of the building code in the jurisdiction in which the home is located to interpret the warranty provisions.

3) Render a decision in writing within sixty (60) days of respondents' receipt of the initiation fee. The arbitrator shall provide a copy of that decision to the homeowner and respondents within one week of rendering it. The arbitrator's decision shall be binding on respondents but not on the homeowner, who, at the time he/she receives a copy of the arbitrator's decision, shall be provided by the arbitrator or respondents with notice of his/her right to accept or reject the offer, along with notice that:

a) If the homeowner accepts the decision, he/she has the right to submit any dispute over compliance with the decision to the dispute resolution mechanism; and

b) If the homeowner rejects the decision, he/she has the right to pursue any other legal remedies available to him/her.

F. The arbitrator shall include in his/her decision an award of reimbursement of the initiation fee unless the arbitrator determines that the homeowner's claim was not substantially justified.

ATTACHMENT 1 TO APPENDIX B

Dear Ward/Richlynn Homeowner:

This letter is to notify you that you may be entitled to certain repairs made to your home free of charge. You may also be entitled to be reimbursed for money you already spent repairing your home.

Ward Development Company, Inc. ("Ward") and Richlynn Development, Inc. ("Richlynn") recently agreed with the Federal Trade Commission to make certain home repairs without charge or to reimburse homeowners for repairs previously paid for by homeowners. If you purchased (that is, took title to) a home from Ward or Richlynn from March 10, 1978, to [*one year prior to date of service of the Order*] and still own that home today, you may be entitled to have no-cost repairs made under the written warranty we gave you. A copy of this warranty is attached to this letter as Appendix A. You may also be entitled to have no-cost repairs made to items that were listed during the pre-settlement inspection you made around the time you took title to your home. In addition, you may be entitled to reimbursement for money you spent repairing your home due to Ward or Richlynn's failure to do the repairs covered by the warranty or the pre-settlement inspection list.

Warranty Problems

You are eligible for a repair or reimbursement under the warranty if all of the following are true:

1. During your first year of ownership, you experienced a problem that was covered by the warranty;

2. You, Ward or Richlynn have some credible written evidence that you notified Ward or Richlynn of the problem during your first year of ownership. (If you do not have a letter or any other written record that you made a complaint to Ward or Richlynn, we will check our customer files to see if we have any record of your complaint. Our files may contain a work order, for example. We will consider your claim for a warranty problem *only* if there is some credible written evidence that you notified us of the problem during your first year of ownership.)

3. Ward or Richlynn refused to repair the problem or inadequately repaired the problem; and

4. The claim has a value of $500 or more, measured by the highest of the following:

- The reasonable estimated cost of repair by a contractor; or
- The homeowner's actual out-of-pocket expenses reasonably spent to repair the problem.

Pre-Settlement Inspection Items

You are eligible for a repair or reimbursement pursuant to the pre-settlement inspection list if all of the following are true:

1. The item was listed on the Orientation Inspection Sheet;

2. Ward or Richlynn refused to repair the item or inadequately repaired the item, and

3. The claim has a value of $500 or more, measured by the highest of the following:

- The reasonable estimated cost of repair by a contractor; or
- The homeowner's actual out-of-pocket expenses reasonably spent to repair the problem.

Limitation on Repair or Reimbursement Under the Warranty or Pre-Settlement Inspection List

Please note, however, that if you have modified the part of your home affected by the claimed problem or item in a manner that substantially increases the cost of repair or correction, you must establish that the problem or item existed prior to the modification. And, even then, we will not bear the increase in cost of repair or correction resulting from the modification. For example, if you finished your basement and thus covered up the problem, we cannot be responsible for the cost of refinishing your basement after our repair work.

What You Must Do

If you think you are eligible for repairs or reimbursement under the warranty or the pre-settlement inspection or both, please fill out the enclosed "Claim Form" and mail it to:

> Att: (*name of Ward/Richlynn representative*)
> Ward/Richlynn
> 1300 Piccard Drive
> Rockville, Maryland 20850

You *must* mail this claim form by 60 days from the mailing date of this letter. If you miss the deadline, you will lose your right to repairs or reimbursement under the terms of our agreement with the Federal Trade Commission. Remember to keep a copy of your claim form and a record of the date you mail it, just in case your claim gets lost in the mail.

Ward/Richlynn will notify you within sixty (60) days of receipt of your claim form about whether we will honor your claim. If you are not satisfied with what we offer you as a repair or reimbursement, you will have the right to take the dispute to an impartial arbitrator. If Ward/Richlynn disputes any part of your claim, we will tell you why we are disputing the claim. You will also have the right to take this dispute to an impartial arbitrator. A description of the arbitration procedures is attached to this letter as Appendix B.

If you have any questions about this repair and reimbursement program, call [name of Ward/Richlynn representative] at [phone number] between the hours of 8:30 a.m. and 5:00 p.m., Monday through Friday.

If you have any comments or concerns about how well Ward/Richlynn is responding to your claim, you might wish to send them to the Federal Trade Commission, Division of Enforcement, Bureau of Consumer Protection, Washington, D.C. 20580. Do *not* send your claim form to that address; if you do so you might lose your right to repairs or reimbursement due to delays in Ward/Richlynn's receipt of the claim form.

Very truly yours,

Ward Development Company, Inc.
Richlynn Development, Inc.

Enclosures

ATTACHMENT 2 TO APPENDIX B

CLAIM FORM

This claim form must be mailed by 60 days from the mailing date of the letter of notification. If you miss this deadline, you will lose your right to repairs or reimbursement under the terms of the agreement between Ward/Richlynn and the Federal Trade Commission.

I.

Name(s) of Homeowner(s) ____________________

Telephone (Home) ____________________

(Work) ____________________

Mailing Address ____________________

(Street)

____

(City) (State) (Zip Code)

Today's date ____________________

II.

I(we) purchased a home from:
( ) Ward Development Company, Inc.
( ) Richlynn Development, Inc.
( ) An affiliate of Ward Development or Richlynn Development

____

(Enter name of company)

III.

The date of settlement/closing on my(our) Ward/Richlynn home was (Enter date you took title).

IV.

MARK ONE

( ) Yes, I(we) am(are) the current owner of this Ward/Richlynn home.
( ) No, I(we) do not currently own this Ward/Richlynn home.

NOTE:

To be eligible for repairs or reimbursement by Ward/Richlynn, you must be *both* the purchaser of a new home from Ward/Richlynn from March 10, 1978, to [one year prior to date of service of the Order] *and* the current owner of this Ward/Richlynn home.

V.

The address of my(our) Ward/Richlynn home is

____

(Street)

____

(City) (State) (Zip Code)

____

(Name of Subdivision)

VI.

INSTRUCTIONS FOR WARRANTY CLAIMS

- Use additional sheets of paper if necessary.
- List each problem separately.
- Describe in detail the nature of the problem.
- Attach a copy (*not* originals) of any written evidence you have that you notified Ward or Richlynn of the problem during your first year of ownership.
- If you are requesting reimbursement for money you spent for repairs, attach the following: a description of the repairs which were made, a copy (*not* originals) of the cancelled check or receipt showing that you paid for repairs, and a copy (*not* originals) of any other document(s) you have that shows what repairs were made and what you paid for them.

NOTE:

If you do not have any written record that you made a complaint to us about a warranty problem, we will check our customer files to see if we have any written records (such as work orders) that you made a complaint to us. We will consider your claim for repair or reimbursement for a warranty problem *only* if there is some credible written evidence that you notified us about the problem in your first year of ownership. If no one has any written evidence that you made a complaint about the warranty problem, we can deny your claim for that problem.

Warranty Claims

I(we) request Ward/Richlynn to make the following repair(s) or reimburse me(us) under the warranty:

VII.

INSTRUCTIONS FOR PRE-SETTLEMENT CLAIMS

- Use additional sheets of paper if necessary.
- List each problem separately.
- Describe in detail the nature of the problem.
- Attach a copy (*not* originals) of the pre-settlement inspection list, if you have it.
- If you are requesting reimbursement for money you spent for repairs, attach the following: a description of the repairs that were made, a copy (*not* originals) of the cancelled check or receipt showing that you paid for repairs, and a copy (*not* originals) of any other document(s) you have that shows what repairs were made and what you paid for them.

Pre-Settlement Inspection Claims

I(we) request Ward/Richlynn to make the following repair(s) or reimburse me(us) pursuant to the pre-settlement inspection list:

APPENDIX C

Dear Ward/Richlynn Homeowner:

This letter is to notify you that you may have the right to use arbitration to settle disputes with Ward/Richlynn.

Ward Development Company, Inc. ("Ward") and Richlynn Development, Inc. ("Richlynn") recently agreed with the Federal Trade Commission to set up an arbitration procedure which would be available at a reasonable cost to homeowners. If you purchased (that is, took title to) a new home from Ward or Richlynn from [*364 days prior to date of service of Order to one day prior to date of service of Order*] and still own that home today, you have the right to submit certain disputes to arbitration. Disputes that can go to arbitration include:

- Any disagreements you have with Ward/Richlynn about its performance under the one year written warranty given to you when you purchased the home. (For example, you may disagree with Ward/Richlynn's refusal to repair a problem that you believe is covered by the warranty. Or you may believe that Ward/Richlynn's attempts to repair a problem were inadequate. You can take these kinds of disputes to arbitration.)
- Any disagreements you have with Ward/Richlynn about its handling of problems and items listed during your pre-settlement inspection. (For example, you may believe that Ward/Richlynn has not corrected all of the items listed on the Orientation Inspection Sheet. Or you may dispute the adequacy of Ward/Richlynn's repairs. You can submit these disagreements to arbitration.)

You may use this arbitration procedure at any time, even after the one year warranty period is over. The expiration of the one year warranty period does *not* affect your right to arbitrate disputes that arise during the warranty period. A copy of the arbitration procedures is attached to this letter. Please read these procedures carefully.

If you have any questions about this arbitration procedure, call [name of Ward/Richlynn representative] at [phone number] between the hours of 8:30 a.m. and 5:00 p.m., Monday through Friday.

Very truly yours,

Ward Development Company, Inc.
Richlynn Development, Inc.

Enclosure

IN THE MATTER OF

CALIFORNIA MEDICAL ASSOCIATION

MODIFYING ORDER IN REGARD TO ALLEGED VIOLATIONS OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-2967. Consent Order, April 17, 1979—Modifying Order, April 19, 1985

In response to a petition filed by the California Medical Association ("CMA"), this Order reopens the proceeding and modifies the consent order entered in Docket C-2967, 93 F.T.C. 519, by deleting Paragraph II(C), which prohibits the association from advising in favor of or against any relative value scale developed by third parties, and inserting a provision that permits CMA more freedom to discuss issues relating to reimbursement with governmental entities and third-party payers. Such modification is consistent with the Commission's decision in Docket 9219, *Michigan State Medical Society,* 101 F.T.C. 191, and its modified order in Docket C-2855, *American College of Obstetricians and Gynecologists,* 104 F.T.C. 524 (1985). The Commission, however, denied the other modifications requested by CMA, holding that CMA had failed to show that changed circumstances or the public interest warranted further modification of the order.

ORDER REOPENING AND MODIFYING FINAL ORDER

By petition filed October 1, 1984, the California Medical Association ("CMA") asked the Commission to reopen and modify the Commission order in Docket No. C-2967 ("Order") entered with CMA's consent on April 17, 1979 [93 F.T.C. 519]. CMA requested that the Commission modify the Order by a) deleting Paragraph II(C) of the Order, which prohibits CMA from advising in favor of or against any relative value scale developed by third parties (except that CMA is permitted to provide historical data), and b) inserting a provision identical to a provision contained in the Commission's Order in *Michigan State Medical Society,* Docket No. 9129, 101 F.T.C. 191 (1983) (*"Michigan State"*) that would allow CMA more freedom to discuss issues relating to reimbursement with third-party payers and governmental entities. CMA also requested that the Commission modify the order so that it would no longer prohibit CMA from developing and disseminating a relative value scale. CMA's petition was placed on the public record for comment, and none of the comments received specifically related to the modification of Paragraph II(C).

Upon consideration of CMA's petition and other relevant information, the Commission finds that the public interest would be served by deleting Paragraph II(C) of the Order and by inserting the relevant provision contained in the order in *Michigan State.* Modification is consistent with both the Commission's decision in *Michigan State* and its modification of the Order in *American College of Obstetricians and Gynecologists,* Docket No. C-2855, August 28, 1984 [104 F.T.C. 524].

The Commission has denied the other modifications requested by CMA because CMA failed to show that changed circumstances or the public interest requires such modifications of the order. Therefore, the Order continues to prohibit CMA from developing or circulating its own relative value guide for use by its members.

Relative value studies may have anticompetitive consequences in several ways. First, they establish price relationships that may become stable without regard to quality or efficiency differences. Second, they may result in new and separate billing categories that are fragmented from others, thereby resulting in higher prices simply because charges are made for more numerous services. Third, if medical associations were permitted to publish RVS's it could lead to concerted or interdependent adherence to an RVS by physicians. Fourth, RVS's may facilitate an actual agreement by physicians to fix prices by providing a "starting point" from which collusion may occur. Given these possibilities of competitive harm and the absence of a convincing showing of the need for CMA to develop an RVS, we believe the public interest lies in the continuation of the prohibition against CMA.

In addition, although the Order no longer will prohibit CMA from discussing relative value scales with governmental entities and third-party payers, serious antitrust concerns would arise were CMA to negotiate or attempt to negotiate an agreement with any such party or engage in any type of coercive activity to effect such an agreement.

Accordingly,

It is ordered, That this matter be, and it hereby is, reopened and that the Order in Docket No. C-2967 be modified 1) to delete Paragraph II(C) and to redesignate Paragraphs II(D) and II(E) of the Order as Paragraphs II(C) and II(D) respectively; 2) to renumber Paragraphs III, IV and V of the Order as Paragraphs IV, V and VI respectively; and 3) to insert the following:

III.

It is further ordered, That this order shall not be construed to prevent CMA from:

A. Exercising rights permitted under the First Amendment to the United States Constitution to petition any federal or state government, executive agency, or legislative body concerning legislation, rules or procedures, or to participate in any federal or state administrative or judicial proceeding.

B. Providing information or views, on its own behalf or on behalf of its members, to third-party payers concerning any issue, including reimbursement.

IN THE MATTER OF

DESCENT CONTROL, INC.

CONSENT ORDER, ETC. IN REGARD TO ALLEGED VIOLATION OF SECTION 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3152. Complaint, April 29, 1985—Decision, April 29, 1985

This consent order requires a Fort Smith, Ark. marketer and distributor of the "Sky Genie" and other descent systems that are used for descent, rescue, or escape from high places, among other things, to cease misrepresenting that any descent system provides an automatically-controlled descent or contains long-lasting line. The order requires the company to have a reasonable basis consisting of specified data before making claims concerning the safety and performance characteristics of descent systems; or representations that the products meet or exceed any standard or are used as sold by any government agency or non-government organization. The firm is also required to disclose in catalogs, technical bulletins and operating instructions that the line should be replaced after two uses for rapid descent at speeds exceeding 15 feet per second; and that the line must be replaced immediately if exposed to certain chemicals or used to arrest a free fall of two feet or more. Technical bulletins and operating instructions must warn users that a line that has been used as a utility line should not be used as a safety line; that the safety and speed of descent is dependent upon manual control by the user; and that descent systems should not be used by individuals who are unfamiliar with their use. Additionally, the firm is required to affix a warning label to all descent systems; mail specified safety information to past purchasers; and place advertisements containing the safety information in specified trade publications.

Appearances

For the Commission: *Jeffrey M. Karp.*

For the respondent: *Joseph Weiss, Weiss and Golden,* Philadelphia, Pa.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, as amended, 15 U.S.C. 45 *et seq.*, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that respondent Descent Control, Inc., hereinafter referred to as respondent, has violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint, stating its charges as follows:

PARAGRAPH 1. Respondent Descent Control, Inc., is a corporation organized, existing, and doing business under and by virtue of the laws of the State of California, with its office and principal place of business located at 3920 Ayers Road, P.O. Box 6405, Fort Smith, Arkansas.

PAR. 2. Respondent is now and for sometime in the past has been engaged in the manufacturing, advertising, marketing, distributing, and selling to the public of "Sky Genie Descent Systems", which are devices for work in, and descent, escape and rescue from, high places. Such devices consist of a nylon line, aluminum shaft, cylindrical shaft cover, and a variety of harnesses, belts, seats and scaffolds.

PAR. 3. In the course and conduct of its business, respondent causes, and in the past has caused, Sky Genie Descent Systems to be offered and sold from its place of business to purchasers located in various States of the United States and the District of Columbia. Respondent maintains and, at all times mentioned herein, has maintained a substantial course of trade in said products in or affecting commerce, as "commerce" is defined by the Federal Trade Commission Act, as amended.

PAR. 4. In the further course and conduct of its aforesaid business, respondent has at all times mentioned herein made numerous statements, orally and in writing, in various advertisements, promotional and packaging materials prepared and/or disseminated by respondent for use in selling respondent's products. Illustrative and typical, but not inclusive of the statements employed as aforesaid, are the following:

1. Descent control device for perfectly controlled descent from high places . . .
2. EASY TO USE systems are preset for the desired rate of descent by the number of line turns made around the shaft . . . Pre-adjustable to a wide range of weight loads and desired speed of descent . . .
3. SKY GENIE LINE . . . special woven, rot and mildew resistant nylon, stronger—many years longer lasting with shock absorbing elasticity built-in . . .
4. All SKY GENIE equipment meets or exceeds O.S.H.A. standards for lifelines, boatswain chairs, escape and rescue use.
5. O.S.H.A. standards met or exceeded where applicable.
6. SKY GENIE DESCENT SYSTEMS ARE IN USE BY . . . Army . . .

PAR. 5. Through the use of the aforesaid statements, respondent has represented and continues to represent, directly or by implication, that:

1. presetting the device by the number of turns of the rope around the shaft provides an automatically controlled descent which does not depend on user control;
2. the nylon line of the Sky Genie descent systems is safe and

durable for long periods of time under repeated use for work, descent, rescue or escape;

3. all Sky Genie descent systems equipment meet or exceed all applicable OSHA standards, and, in particular, OSHA standards for lifelines, boatswain chairs, and escape and rescue; and

4. Sky Genie descent systems are used, in the form such systems are offered for sale, by the U.S. Army.

PAR. 6. In truth and in fact:

1. presetting the device by the number of turns around the shaft does not provide an automatically controlled descent; rather, speed of descent is dependent upon user control;

2. the nylon line of the Sky Genie descent systems is not safe or durable for long periods of time when used for rapid descents or to arrest a free fall. The nylon line of the Sky Genie descent systems is subject to failure or breakage after two uses for descents at speeds in excess of 15 feet per second, or after one use to arrest a free fall of 2 feet or more;

3. Sky Genie descent systems do not meet or exceed all applicable OSHA standards;

4. all lines distributed and sold by respondent do not meet or exceed OSHA standards for lifelines; only the 1/2" line meets OSHA standards for lifelines;

5. the Sky Genie boatswain chair descent system does not meet OSHA standards;

6. no OSHA standards exist for lines used in escape and rescue;

7. The U.S. Army does not use the Sky Genie descent systems in the form such systems are offered for sale by respondent. The U.S. Army uses the Sky Genie descent systems only after modifying them because the Sky Genie descent systems, in the form such systems are offered for sale, do not meet Army standards for escape and rescue devices.

Therefore, the representations set forth in Paragraph Five were, and are, false and misleading.

PAR. 7. Paragraphs Four, Five and Six are hereby incorporated by reference. In the course and conduct of its business, respondent has represented and continues to represent that the Sky Genie descent systems, when used according to instructions, are safe and effective for work in, and descent, rescue and escape from, high places.

PAR. 8. In truth and in fact, the Sky Genie descent systems, when used according to instructions, are not safe and effective for work in, and descent, rescue and escape from, high places because the instructions fail to disclose to purchasers the following material facts concerning the safe use and proper maintenance of the Sky Genie descent systems:

1. user control, and not any presetting of the device, determines the speed of descent;

2. the nylon line should be replaced after two uses for rapid descent at speeds in excess of 15 feet per second;

3. the nylon line must be replaced immediately if used once to arrest a free fall of 2 feet or more; and

4. the nylon line must be replaced immediately if exposed to certain chemicals commonly found in and around construction and maintenance sites.

PAR. 9. Respondent's representation, set forth in Paragraph Seven, by reason of its failure to disclose the facts described in Paragraph Eight, is misleading in a material respect in that the disclosure of these facts to purchasers would be likely to affect their purchasing and/or product use decisions. Therefore, the failure to disclose these material facts renders the representation referred to in Paragraph Seven false and misleading.

PAR. 10. The acts and practices of respondent, herein alleged, were and are all to the prejudice and injury of the public and constituted and now constitute unfair and deceptive acts or practices in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act. The acts and practices of respondent, as herein alleged, are continuing.

DECISION AND ORDER

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondents with violation of the Federal Trade Commission Act; and

The respondent, its attorney, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondent has violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Descent Control, is a corporation organized, existing and doing business under and by virtue of the laws of the State of California with its office and principal place of business located at 3920 Ayers Road, P.O. Box 6405, Fort Smith, Arkansas.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

ORDER

For the purpose of this Order, the following definitions shall apply:

1. *Descent Control* means Descent Control, Inc., its subsidiaries, successors and assigns, and any other entity continuing the business of Descent Control, Inc., that has actual knowledge of this Order.

2. *descent systems* means all hardware, rope and other components which are marketed and sold for the purpose of work in, or descent, rescue or escape from, high places.

3. *person* means any individual, partnership, corporation, firm, trust, estate, cooperative, association, or other entity.

4. *distributor* means any person who, pursuant to a sales agreement with Descent Control, purchases or receives on consignment descent systems for resale to the public.

5. *owner* means any person who purchased a Sky Genie descent system directly from Descent Control or from a distributor.

I.

It is ordered, That respondent Descent Control, Inc., a corporation, its successors and assigns, and its officers, agents, representatives, and employees, directly or through any corporation, subsidiary, division or other device, in connection with the advertising, offering for sale, sale or distribution of Sky Genie descent systems, or any other descent systems, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from disseminating, or causing the dissemination of, any advertisement, promotional material, operating instruction, technical manual, label, packaging, or catalog, which represents directly or by implication:

a. that any such descent systems provide an automatically controlled descent, unless such is the case;

b. that any nylon line within any such descent systems is long-lasting, unless such is the case;

c. that any such descent systems meet or exceed a standard of any government agency or non-government organization unless:

(i) there is disclosed clearly and prominently, in close conjunction therewith, a description of which standard is met or exceeded and whether all or only part of the descent systems meet or exceed such standard; and

(ii) at the time the representation is made Descent Control possesses and relies upon a reasonable basis for the representation.

d. that any such descent systems are used, in the form such systems are offered for sale, by any government agency or non-government organization, unless, at the time the representation is made, Descent Control possesses and relies upon a reasonable basis for the representation consisting of a verified written statement from the agency or organization which is claimed to use the descent systems attesting to such use; and

e. any safety or other performance characteristic of any such descent systems, unless, at the time the representation is made, Descent Control possesses and relies upon a reasonable basis for the representation consisting of competent and reliable objective evidence substantiating the representation.

II.

It is further ordered, That respondent Descent Control, Inc., a corporation, its successors and assigns, and its officers, agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the advertising, offering for sale, sale or distribution of the Sky Genie descent systems, or any other descent systems, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from failing to disclose clearly and prominently in each catalog for such systems the following:

1. that the line should be replaced after two uses for rapid descent at speeds in excess of 15 feet per second;

2. that the line must be replaced immediately if once used to arrest a free fall of 2 feet or more; and

3. that the line must be replaced immediately if exposed to any chemicals listed in the operating instructions.

III.

It is further ordered, That respondent Descent Control, Inc., a corporation, its successors and assigns, and its officers, agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the advertising, offering for sale, sale or distribution of the Sky Genie descent systems, or any other descent systems, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from failing to disclose clearly and prominently in each technical bulletin and operating instruction for such descent systems adequate instructions for safe and proper use, including, but not limited to, the following:

1. that the line which is a component of the descent systems should be replaced after two uses for rapid descent at speeds in excess of 15 feet per second;

2. that the line must be immediately replaced if once used to arrest a free fall of 2 feet or more;

3. that the line must be replaced immediately if exposed to any of the following chemicals [herein Descent Control should identify all chemicals which it knows or has reason to know would adversely affect the line in its descent systems];

4. that the line should not be used as a safety line if it has ever been used as a utility line;

5. that the descent systems are not appropriate or safe for use as personal emergency or self-rescue devices by individuals who are not familiar with the proper use and application of the devices; and

6. that the safety and speed of descent of users of the descent systems is dependent upon manual control by the user.

IV.

It is further ordered, That respondent Descent Control, Inc., a corporation, its successors and assigns, and its officers, agents, representatives, and employees, directly or through any corporation, subsidiary, division or other device, in connection with the advertising, offering for sale, sale or distribution of the Sky Genie descent systems, or any other descent systems, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from failing to affix to each such descent system and to the packaging thereof a permanent white-adhesive label disclosing clearly and prominently in red letters:

> WARNING: This line is subject to breakage under certain conditions. See operating manual for details.

V.

It is further ordered, That Descent Control shall within thirty (30) days after the date of service of this order:

1. provide each of its distributors with the labels described in Part IV and with technical bulletins and operating instructions which contain the disclosures required by Part III in sufficient number to cover each distributor's existing inventory of descent systems; and
2. instruct and use its best efforts to ensure that each distributor affixes such labels to each descent system and its packaging and includes such technical bulletins and operating instructions with each descent system in the distributor's inventory.

VI.

It is further ordered, That Descent Control shall send to each owner identified by its records and to each owner identified by its distributors' records, by first class mail, within sixty (60) days after the service of this order, a copy of the letter attached hereto as Appendix A in an envelope clearly stamped on the front with the words "Contains Important Product Safety Information."

VII.

It is further ordered, That Descent Control shall, within thirty days after the date of service of this Order, place or cause to be placed, in the manner described below, the announcement attached hereto as Appendix B, beginning as soon as space is available, in three consecutive issues of *Occupational Hazards,* and *Industrial Safety and Hygiene News,* and *National Safety News.*

The printed announcement shall be no smaller than one quarter page in size, and shall not include any additional text or graphics.

VIII.

It is further ordered, That Descent Control shall distribute a copy of this Order to each present and future officer, employee, agent and representative having sales, advertising, or policy making responsibilities for any descent systems and secure from each such person a signed statement acknowledging receipt of said Order.

IX.

It is further ordered, That Descent Control shall maintain for at least three years and upon request make available to the Federal Trade Commission for inspection and copying the originals of signed statements required by Part VIII of this Order and all test results, data, and other documents or information relied upon for any representation for any descent systems and any information in the possession of Descent Control which contradicts, qualifies or calls into serious question that representation.

X.

It is further ordered, That respondent notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondent such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporation which may affect compliance obligations arising out of the Order.

XI.

It is further ordered, That respondent shall, within ninety (90) days after service upon it of this Order, file with the Commission a report in writing, setting forth in detail, the manner and form in which it has complied with this Order.

APPENDIX A

Dear Customer:

Our records show that you have purchased a Sky Genie descent system. Recently, it has come to our attention that users of this product may not be aware of necessary precautions to ensure safe use. Therefore, as a result of an agreement with the Federal Trade Commission, we are contacting all of our Sky Genie customers to alert them about the following precautions.

1. THE LINE MAY BREAK if used more than 2 times for rapid descents at speeds

in excess of 15 feet per second (for example, rappelling or using it as a climbing rope). Replace the line after 2 rapid descents.

2. DO NOT use the rope as a safety line if it has ever been used as a utility line.

3. Replace the line IMMEDIATELY after it has been used to arrest a free fall of 2 feet or more.

4. Replace the line IMMEDIATELY if it has been exposed to any of the following chemicals:

Hydrochloric acid
Nitric acid
Muriatic acid
Sulfuric acid
Acetic acid
Oxalic acid
Phenol
Nitrobenzene

5. The number of turns of the line around the shaft of the Sky Genie will NOT automatically ensure a controlled rate of descent. The user must be prepared to manually control the descent in order to prevent an uncontrolled fall.

6. The durability and life of the line will vary significantly depending on how and where it is used. In order to ensure safe use in an emergency, inspect the line carefully before each use. Look for broken, cut or pulled strands, worn fibers, or any hardening or discoloring of portions of the line. If any of these warning signs are present, the line may break.

If you have any questions on the use and care of the Sky Genie descent system, please write Descent Control, P.O. Box 6405, Fort Smith, Arkansas 72906, or call (800) 643-2539.

Sincerely yours,

President

READEX FICHE

APPENDIX B

IMPORTANT SAFETY INFORMATION

[insert company logo]

For owners of

SKY GENIE DESCENT SYSTEMS

Your **SKY GENIE** line may break or you may suffer an uncontrolled fall if you don't use it properly—follow these important steps for safe use:

1. REPLACE THE LINE when it's been used to arrest a free fall of 2 feet or more.
2. REPLACE THE LINE when it's been exposed to any of the following chemicals: Hydrochloric, Nitric, Muriatic, Sulfuric, Acetic or Oxalic acids, Phenol or Nitrobenzene.
3. REPLACE THE LINE after two rapid descents at speeds in excess of 15 feet per second.
4. BE PREPARED to manually control the speed of descent. The number of turns of the line around the shaft will **not** automatically ensure a controlled descent.

* For further information, write: Descent Control, P.O. Box 6405, Fort Smith, Arkansas 72906, or call (800) 643-2539.

IN THE MATTER OF

P. LEINER NUTRITIONAL PRODUCTS CORP., ET AL.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF SECS. 5 AND 12 OF THE FEDERAL TRADE COMMISSION ACT

Docket 9173. Complaint, Jan. 27, 1984—Decision, May 3, 1985

This consent order requires two California firms engaged in the advertising, labelling, packaging, sale and distribution of nutritional supplements, among other things, to cease representing falsely or without proper substantiation, that Octacol 4 or any similar product can improve human vigor, endurance or other aspects of physical performance or fitness; or that the Octacosano, Triacontanol, Hexacosanol or tetracosanol contained in their products are related to athletic endurance or physical fitness. The firms are also barred from making claims regarding physical benefits to be derived from using such products unless they are properly substantiated; and from misrepresenting the purpose, reliability, results or conclusions of any test, research, article or scientific opinion. Additionally, the companies are required to maintain for a period of three years all materials that substantiate or contradict representations covered by the order.

Appearances

For the Commission: *Cheryl B. Anderson, Teresa A. Hennessy* and *Brinley H. Williams.*

For respondents: *Henry P. Sailer* and *Jonathan L. Wiener, Covington & Burling,* Washington, D.C.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that PLNP Holdings, Inc., a corporation, and P. Leiner Nutritional Products, Inc., a corporation, hereinafter referred to as respondents, have violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Respondent PLNP Holdings, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of California. Respondent P. Leiner Nutritional Products, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware. Respondent PLNP

Holdings, Inc. dominates or controls, knew of and approved, or benefits from the acts and practices of its only and wholly-owned subsidiary, P. Leiner Nutritional Products, Inc., including the acts and practices hereinafter set forth. Both corporate respondents have their offices and principal places of business at 1805 West 205th Street, Torrance, California.

PAR. 2. Respondents are now and for some time last past have been engaged in the manufacture, offering for sale, and sale of nutritional supplements, including Octacol 4, and other products for personal or household use by members of the general public (hereinafter "consumer products").

PAR. 3. Respondents have caused to be prepared and placed for publication and have caused the dissemination of advertising and promotional material, including, but not limited to, the advertising and labeling referred to herein, to promote the sale of Octacol 4. As advertised, Octacol 4 is a "food" within the meaning of Section 12 of the Federal Trade Commission Act.

PAR. 4. PLNP Holdings, Inc., and P. Leiner Nutritional Products, Inc., operate in various States of the United States and in the District of Columbia. Respondents' manufacture, offering for sale, sale, and distribution of nutritional supplements, including Octacol 4, mentioned herein constitutes maintenance of a substantial course of trade in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act.

PAR. 5. In the course and conduct of their businesses, respondents have disseminated and caused the dissemination of advertisements for nutritional supplements, including Octacol 4, by various means in or affecting commerce, including national magazines, product labels, point of sale brochures, distributed by the mail and across state lines, for the purpose of inducing and which were likely to induce, directly or indirectly, the purchase of said products.

PAR. 6. Typical statements in said advertisements, and promotional materials, disseminated as previously described, but not necessarily inclusive thereof, are found in advertisements and promotional materials attached hereto as Exhibits A through D. Specifically, the aforesaid advertisements contain the following statements:

(a) Octacol 4 Helps Increase Endurance, Stamina and Vigor .

(b) . . . Octacol 4 contains all *four* sports stamina factors reported in U.S. Patent No. 3,031,376—including high content octacosanol (Emphasis in Original).

(c) To help you play stronger, play longer .

(d) Octacol 4 contains all *four* sports stamina factors reported in U.S. Patent No. 3,031,376. Triacontanol. Tetracosanol. Hexacosanol. And high-content octacosanol. Result? Octacol 4 can help you get the most from your favorite sport—jogging, swimming, dancing, weight training, tennis or skiing .

(e) . . . [I]n long-term university studies and related research, published results indicate that the four performance factors now available in Octacol 4—including high content Octacosanol—have shown significant effects on several types of human endurance. Result? Athletes participating in these research studies were able to play and perform stronger, longer .

(f) In particular, Octacol 4 may benefit athletes and active people participating in these extra effort sports:

Aerobics
Basketball
Dance
Football
Hockey
Jogging
Racquet Sports
Running
Soccer
Swimming
Skiing
Weight Training

PAR. 7. Through the use, *inter alia,* of the statements referred to in Paragraphs Six (a) through Six (f), and other representations contained in advertisements or promotional materials not specifically set forth herein, respondents have represented, and now represent, directly or by implication, that the use of Octacol 4 will improve consumers' endurance, stamina, vigor, overall athletic performance, or overall physical fitness.

PAR. 8. Through the use, *inter alia,* of the statements referred to in Paragraph Six (b) and Six (d), respondents have represented, and now represent, directly or by implication, that Octacol 4 contains four sports stamina and performance factors—octacosanol, triacontanol, tetracosanol, and hexacosanol—that render Octacol 4 effective in improving consumers' athletic endurance or performance or physical fitness.

PAR. 9. Through the use, *inter alia,* of the statements referred to in Paragraph Six (a) through Six (f) respondents have represented, and now represent, directly or by implication, that they possessed and relied upon a reasonable basis consisting of competent and reliable evidence that substantiated the representations referred to in Paragraphs Seven through Eight, at the time they first disseminated those representations and at each subsequent dissemination. Through the use, *inter alia,* of the statements referred to in Paragraph Six (e), respondents further represented:

(a) that, at the time they made the representations referred to in Paragraphs Seven and Eight, they possessed and relied upon scientific studies, conducted and evaluated in an objective manner by persons qualified to do so, using procedures generally accepted in the profession or science to yield accurate and reliable results; and

(b) that the scientific studies referred to in Paragraph Nine (a) provided a reasonable basis consisting of competent and reliable scientific evidence that substantiated the representations in Paragraphs Seven and Eight.

PAR. 10. The representation contained in Paragraph Seven is false, for the reason that the use of Octacol 4 will not improve consumers' athletic endurance, stamina, vigor, overall athletic performance or overall physical fitness.

PAR. 11. The representation contained in Paragraph Eight is false, for the reason that none of the four factors referred to in Paragraph Eight renders Octacol 4 effective in improving consumers' athletic endurance or performance or physical fitness.

PAR. 12. The representations contained in Paragraph Nine are false, for the reasons that respondents did not possess and rely upon a reasonable basis that substantiated the representations referred to in Paragraphs Seven and Eight at the time they made those representations. The representations referred to in Paragraph Nine (a) and (b) are false, for the reasons that the studies referred to:

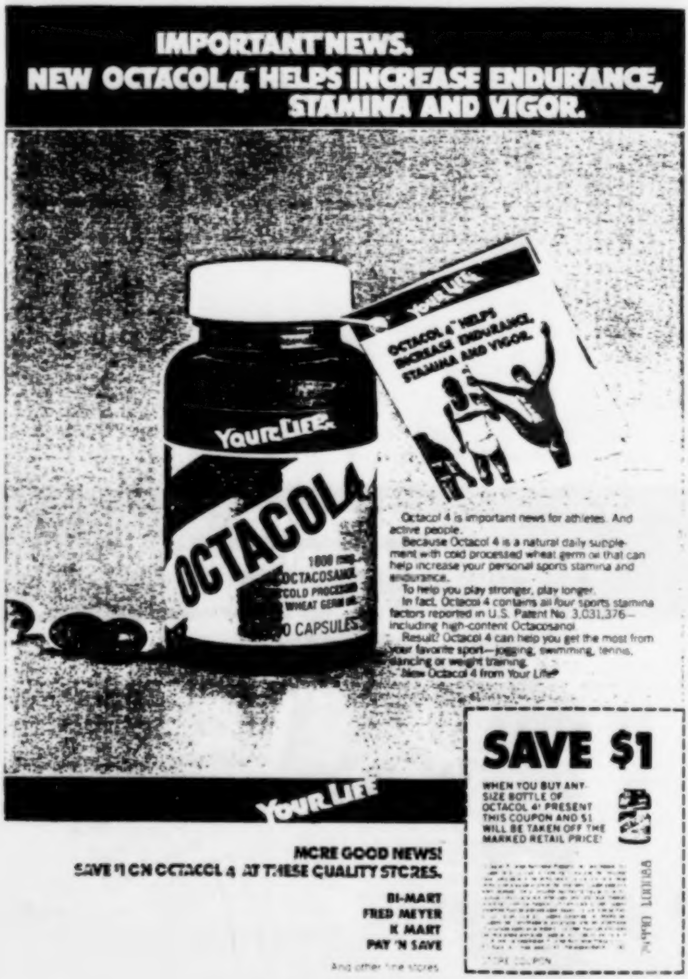
(a) were not conducted and evaluated in an objective manner by persons qualified to do so, using procedures generally accepted in the profession or science to yield accurate and reliable results; and

(b) did not provide a reasonable basis consisting of competent and reliable scientific evidence that substantiated the representations referred to in Paragraphs Seven and Eight.

PAR. 13. The use by respondent of the aforesaid acts and practices, directly or by implication, and the placement in the hands of others of the means and instrumentalities by and through which others may have used the aforesaid statements, representations, acts, and practices, have had and now have the capacity and tendency to mislead consumers and to induce such persons to purchase Octacol 4.

PAR. 14. The aforesaid acts and practices of respondents were and are to the prejudice and injury of the public, and constituted and now constitute unfair or deceptive acts or practices in or affecting commerce and false advertisements in violation of Sections 5 and 12 of the Federal Trade Commission Act.

EXHIBIT A



YOUR LIFE
OCTACOL 4
1000 mcg
OCTACOSANOL
COLD PROCESSED
WHEAT GERM OIL
CAPSULES
YOUR LIFE
OCTACOL 4 HELPS INCREASE ENDURANCE, STAMINA AND VIGOR.
YOUR LIFE

IMPORTANT NEWS.
NEW OCTACOL 4™ HELPS INCREASE ENDURANCE, STAMINA AND VIGOR.

Octacol 4 is important news for athletes. And active people.

Because Octacol 4 is a natural daily supplement with cold processed wheat germ oil that can help increase your personal sports stamina and endurance.

To help you play stronger, play longer.

In fact, Octacol 4 contains all four sports stamina factors reported in U.S. Patent No. 3,031,376—including high-content Octacosanol.

Result? Octacol 4 can help you get the most from your favorite sport—jogging, swimming, tennis, dancing or weight training.

New Octacol 4 from Your Life®

SAVE $1

WHEN YOU BUY ANY SIZE BOTTLE OF OCTACOL 4! PRESENT THIS COUPON AND $1 WILL BE TAKEN OFF THE MARKED RETAIL PRICE!

MORE GOOD NEWS!
SAVE $1 ON OCTACOL 4 AT THESE QUALITY STORES.

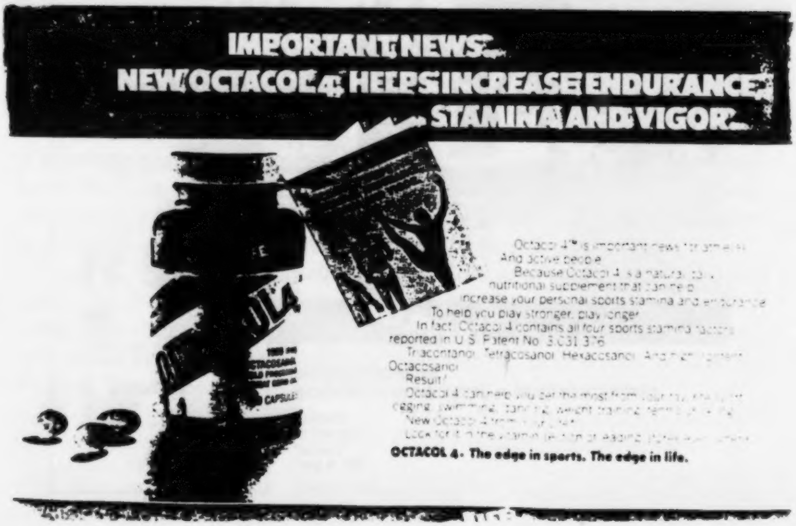
BI-MART
FRED MEYER
K MART
PAY 'N SAVE

And other fine stores.

EXHIBIT B

YOUR LIFE: OCTACOL 4.

AS SEEN IN:
SPORTS ILLUSTRATED
PEOPLE
RUNNER'S WORLD


IMPORTANT NEWS...
NEW OCTACOL 4 HELPS INCREASE ENDURANCE, STAMINA AND VIGOR...
OCTACOL 4
CAPSULES

Octacol 4™ is important news for athletes. And active people.

Because Octacol 4 is a natural, [illegible] nutritional supplement that can help increase your personal sports stamina and endurance. To help you play stronger, play longer.

In fact, Octacol 4 contains all four sports stamina factors reported in U.S. Patent No. 3,031,376. Triacontanol. Tetracosanol. Hexacosanol. And high potency Octacosanol.

Result?

Octacol 4 can help you get the most from your favorite [illegible] cycling, swimming, tennis, weight training, [illegible]

New Octacol 4 from [illegible]

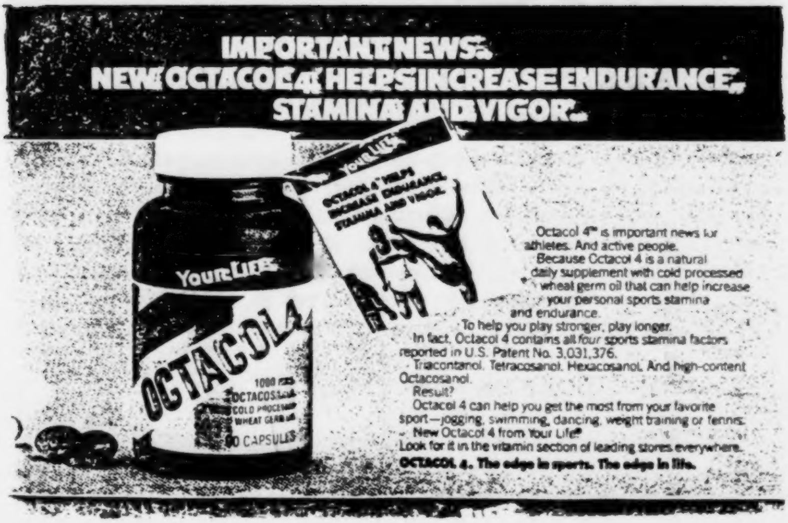
Look for it in the vitamin section of leading [illegible]

OCTACOL 4. The edge in sports. The edge in life.

EXHIBIT C

YOUR LIFE® OCTACOL 4.

AS SEEN IN:
SPORTS ILLUSTRATED
PEOPLE
RUNNER'S WORLD


YOUR LIFE
OCTACOL 4™ HELPS INCREASE ENDURANCE, STAMINA AND VIGOR.
YOUR LIFE
OCTACOL 4
1000 mcg OCTACOSANOL
COLD PROCESSED WHEAT GERM OIL
60 CAPSULES

IMPORTANT NEWS: NEW OCTACOL 4 HELPS INCREASE ENDURANCE, STAMINA AND VIGOR.

Octacol 4™ is important news for athletes. And active people.

Because Octacol 4 is a natural daily supplement with cold processed wheat germ oil that can help increase your personal sports stamina and endurance.

To help you play stronger, play longer.

In fact, Octacol 4 contains all *four* sports stamina factors reported in U.S. Patent No. 3,031,376.

Triacontanol. Tetracosanol. Hexacosanol. And high-content Octacosanol.

Result?

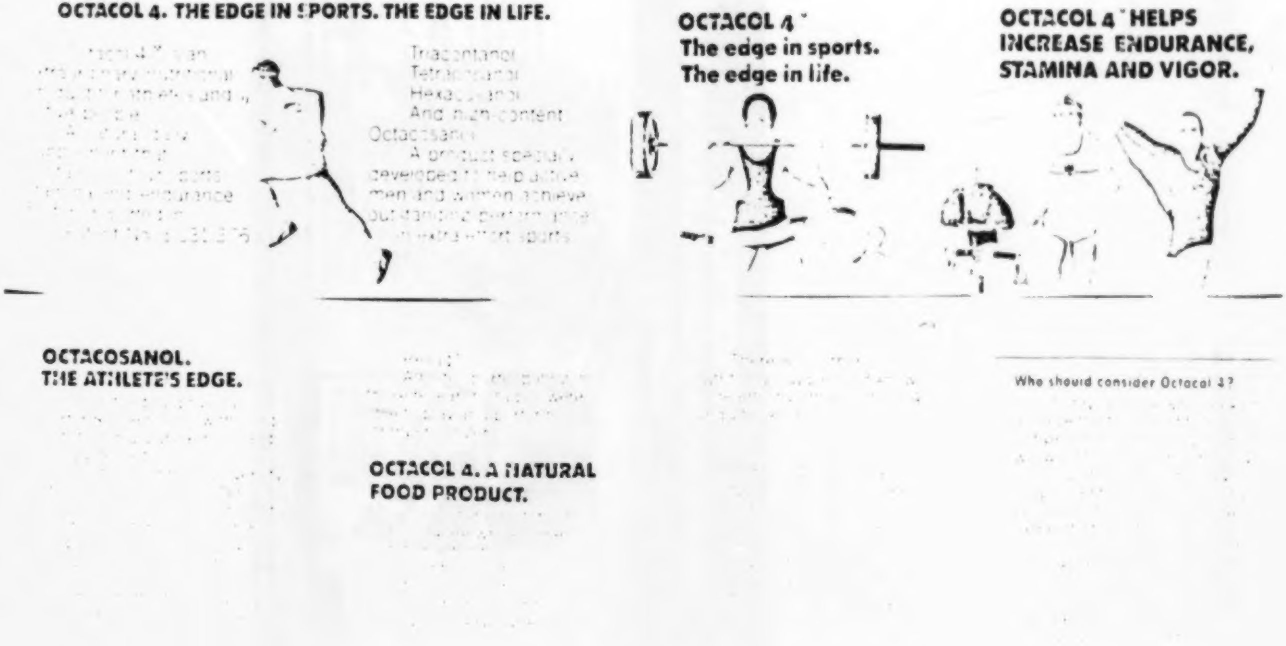
Octacol 4 can help you get the most from your favorite sport—jogging, swimming, dancing, weight training or tennis.

New Octacol 4 from Your Life®

Look for it in the vitamin section of leading stores everywhere.

OCTACOL 4. The edge in sports. The edge in life.

EXHIBIT D



OCTACOL 4. THE EDGE IN SPORTS. THE EDGE IN LIFE.

OCTACOL 4™
The edge in sports.
The edge in life.

OCTACOL 4™ HELPS
INCREASE ENDURANCE,
STAMINA AND VIGOR.

OCTACOSANOL.
THE ATHLETE'S EDGE.

OCTACOL 4. A NATURAL
FOOD PRODUCT.

Who should consider Octacol 4?

SEPARATE STATEMENT OF COMMISSIONER MICHAEL PERTSCHUK* ON COMPLAINT IN P. LEINER NUTRITIONAL PRODUCTS, INC.

I fully support the Commission's decision to issue a complaint in this matter. At the same time, I am disturbed that the Commission has scrapped its traditional practice of pleading a failure to have a reasonable basis for an advertising claim as both an *unfair* as well as a deceptive practice. The complaint issued today charges only that the respondent's claims (both express and implied) that it had substantiation for its advertising claims were false.

One concern is that this unwarranted change in the Commission's standard pleading will cause confusion and uncertainty. Among others, the administrative law judges will naturally wonder whether the Commission intended in some way to change the standard traditionally used to judge unsubstantiated ads.

Further, while the staff have stated that the changes only reflect what staff in fact intend to prove in this particular case, given Chairman Miller's repeated concerns about the advertising substantiation doctrine, this change may also be a step toward abandonment of unfairness as a basis for the advertising substantiation doctrine. If that is the case, it marks a radical departure for the Commission, which has recently plainly stated in its unfairness policy statement sent to Congress that unfairness is a cornerstone of the advertising substantiation doctrine.

No adequate justification has been given for such a change in our legal theory for requiring advertising substantiation. No analysis has been presented on whether such a change will make it more difficult for the Commission to win its cases. And certainly no rationale has been given for making this decision now, rather than waiting for the Commission's review of the comprehensive comments recently filed concerning the Commission's advertising substantiation program.

DECISION AND ORDER

The Commission having heretofore issued its complaint charging the respondents named in the caption hereof with violations of Sections 5 and 12 of the Federal Trade Commission Act, as amended, and the respondents having been served with a copy of that complaint, together with a notice of contemplated relief; and

The respondents, their attorney, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondents of all the jurisdictional facts set forth in the complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondents that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

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* Michael Pertschuk, Commissioner 1977–1984.

The Secretary of the Commission having thereafter withdrawn this matter from adjudication in accordance with Section 3.25(c) of its Rules; and

The Commission having considered the matter and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, now in further conformity with the procedure prescribed in Section 3.25(f) of its Rules, the Commission hereby makes the following jurisdictional findings and enters the following order:

1. Respondent P. Leiner Nutritional Products Corp., is a corporation organized, existing and doing business under and by virtue of the laws of the State of California, with its office and principal place of business located at 1805 West 205th Street, Torrance, California.

2. Respondent P. Leiner Nutritional Products, Inc., of Delaware, is a corporation existing and doing business under and by virtue of the laws of the State of Delaware with its office and principal place of business located at 1805 West 205th Street, Torrance, California.

3. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondents, and the proceeding is in the public interest.

ORDER

I

It is ordered, That respondents P. Leiner Nutritional Products Corp., a corporation, and P. Leiner Nutritional Products, Inc., of Delaware, a corporation, their successors and assigns, and their officers, agents, representatives, and employees, directly or through any corporation, subsidiary, division or other device, in connection with the manufacture, advertising, labeling, packaging, offering for sale, sale or distribution of Octacol 4, or any other product of substantially similar composition, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

A. Representing, directly or by implication, that the product can help consumers improve vigor, stamina, endurance, any aspect of athletic performance, or any aspect of physical fitness.

B. Representing, directly or by implication, that the following ingredients contained in the product are related in any way to athletic endurance or performance or physical fitness—octacosanol, triacontanol, hexacosonal, tetracosanol.

II

It is further ordered, That respondents, their successors and assigns, and their officers, agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the manufacture, advertising, labeling, packaging, offering for sale, sale, or distribution of any product for personal or household use in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from misrepresenting in any manner, directly or by implication, the purpose, content, sample, reliability, results or conclusions of any scientific test, research, or article, or any other scientific opinion or data.

III

A. *It is further ordered,* That respondents, their successors and assigns, and their officers, agents, representatives and employees, directly or through any corporation, subsidiary, division, or other device, in connection with the manufacture, advertising, labeling, packaging, offering for sale, sale, or distribution of any product for personal or household use in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from making any representation, directly or by implication, concerning any benefit to be derived from using any such product with respect to athletic performance or endurance or any improvement in physical capability to be derived from using such product or from comparing any such products to any product or products of one or more competitors concerning the benefits from using any such products with respect to athletic performance or endurance or any improvement in physical capability to be derived from using such product unless, at the time of such representation, respondents possess and rely upon reliable and competent evidence that substantiates each such representation of the type and quantum appropriate for the representation.

B. For the purposes of Part III (A) to the extent evidence consists of scientific or professional tests, analyses, research, studies or any other evidence based on expertise of professionals in the relevant area, such evidence shall be "reliable and competent" only if those tests, analyses, research, studies, or other evidence are conducted and evaluated in an objective manner by persons qualified to do so, using procedures generally accepted in the profession or science to yield accurate and reliable results.

IV

It is further ordered, That respondents, their successors and assigns, and their officers, agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the manufacture, advertising, labeling, offering for sale, sale, or distribution of any product for personal or household use in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from failing to maintain accurate records:

1. Of all materials that were relied upon by respondents in disseminating any representation covered by this order.
2. Of all test reports, studies, surveys, or demonstrations in their possession or control or of which they have knowledge that contradict any representation made by respondents that is covered by this order.

Such records shall be retained by respondents for three years from the date that the representations to which they pertain are last disseminated. It is further ordered that any such records shall be retained by respondents and that respondents shall make such documents available to the Commission for inspection and copying upon request.

V

It is further ordered, That respondents notify the Commission at least thirty (30) days prior to any proposed changes in respondents such as dissolution, assignment, or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporations which may affect compliance obligations arising out of the Order.

VI

It is further ordered, That respondents shall forthwith distribute a copy of this Order to each of their operating divisions and to all distributors of Octacol 4 or any other product of substantially similar composition.

VII

It is further ordered, That respondents shall, within sixty (60) days after service of this Order, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with this Order.

VIII

It is further ordered, That no provision of this Order shall be interpreted as precluding respondents from making statements or disclosures on their labels or labeling where those statements or disclosures are required by regulations promulgated by the Food and Drug Administration (FDA) or by statutes the FDA enforces.

IN THE MATTER OF

THE CITY OF MINNEAPOLIS

ORDER WITHDRAWING COMPLAINT IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket 9180. Complaint, May 10, 1984—Order Withdrawing Complaint, May 7, 1985

This order withdraws the complaint alleging that the City of Minneapolis had combined, contracted or agreed with taxicab companies to pursue certain anticompetitive policies in violation of Section 5 of the Federal Trade Commission Act. The Commission held that changes now made in the City's municipal Code, which includes raising the number of taxicab licenses to be made available to operators, "significantly relieves the injury to competition alleged in the complaint and . . . may eliminate the need for further Commission action." Thus, continuing the matter would not be in the public interest. In withdrawing its complaint, the Commission expressed no opinion as to whether the "liability of the City of Minneapolis could have been established at trial."

Appearances

For the Commission: *Jerry A. Philpott.*

For the respondent: *John French, French, Faegre & Benson,* Minneapolis, Minn. and *Robert J. Alfton* and *Scott Reeves,* City of Minneapolis, Minneapolis, Minn.

COMPLAINT

The Federal Trade Commission, having reason to believe that the City of Minneapolis, a municipal corporation subject to the jurisdiction of the Commission, hereinafter sometimes referred to as Respondent or the City, has violated the provisions of the Federal Trade Commission Act, as amended (15 U.S.C. 45), and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges as follows:

For purposes of this complaint, the following definitions shall apply:

(A) *Taxicab* means any motor vehicle, except a limousine, regularly engaged in the business of carrying passengers for hire, having a seating capacity of less than ten (10) persons and not operated on a fixed route or schedule.

(B) *License* means the annual taxicab vehicle license issued by the

City of Minneapolis that authorizes the holder thereof to operate a taxicab within the City of Minneapolis.

(C) *Owner-operator* means an individual or company that owns at least one taxicab and taxicab license issued by the City of Minneapolis.

(D) *Leasing* means the practice by taxicab owner-operators of entering into an agreement with a person who is authorized by the City of Minneapolis to drive a taxicab, wherein for a rental fee paid to the owner-operator, said driver is entitled to use a taxicab and its corresponding taxicab license for a specified time and retain all fares collected from passengers.

(E) *CPCN* means the certificate of public convenience and necessity issued by the Minneapolis City Council that is the prerequisite for issuance by the City of Minneapolis of a taxicab license.

(F) *Taxicab company* means any business organization, corporation, partnership, cooperative or person that at present (or sometime in the past) has a trade name and color scheme registered with the City of Minneapolis for the purpose of operating taxicabs or providing services related to the business of owning, operating and/or leasing taxicabs to taxicab owners, operators and/or drivers authorized to do business by the City.

PARAGRAPH 1. Respondent is a municipal corporation organized under the laws of the State of Minnesota and is a person or corporation within the meaning of the Federal Trade Commission Act, as amended (15 U.S.C. 45). The City has passed and enforces certain ordinances that regulate the taxicab business in Minneapolis.

PAR. 2. At all times relevant herein, Respondent's acts and practices have affected the businesses of taxicab companies and taxicab owners, operators, drivers or lessees that maintain, and have maintained, substantial courses of business, including the acts and practices as hereinafter set forth, which are in or affect commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, and Respondent is subject to the jurisdiction of the Federal Trade Commission. The acts and practices alleged herein are in or affect commerce by affecting at least the following activities that are in or affect commerce:

(A) Taxicabs and taxicab companies provide a primary method of transportation for interstate travelers between Minneapolis-St. Paul International Airport and destinations in Minneapolis.

(B) Taxicabs and taxicab companies provide transportation for interstate travelers between Minneapolis and nearby cities in Minnesota and Wisconsin.

(C) Taxicabs and taxicab companies provide transportation to interstate travelers between train stations, bus terminals and other destinations in Minneapolis.

(D) Taxicabs and taxicab companies provide transportation to interstate travelers between hotels, motels, places of business, convention centers, and tourist attractions and other destinations in and around Minneapolis.

(E) Taxicabs are manufactured in other states and are sold for use in and are transported into Minnesota.

(F) Items and services purchased in substantial quantities such as gasoline, tires, taximeters, two-way radios and various replacement parts for taxicabs originate in other states and have been transported into Minneapolis.

(G) Employment opportunities as a Minneapolis taxicab driver have attracted persons from other states.

PAR. 3. For many years and continuing up to and including the date of the issuance of this complaint, the City has combined, contracted or agreed with taxicab companies, to pursue the following policies and do the following acts, among others:

(A) To permit and encourage taxicab companies to combine and to agree upon proposals to increase fares for taxicabs in Minneapolis.

(B) To adopt uniform fares applicable to all taxicabs upon request by taxicab companies.

(C) To limit the number of taxicab licenses in Minneapolis and to prohibit by other means, new entry of taxicab drivers, owners and operators into Minneapolis.

(D) To raise unreasonable barriers to entry to new taxicab companies in Minneapolis.

(E) To prohibit competition from vehicles-for-hire licensed outside Minneapolis.

PAR. 4. The acts and practices of Respondent, as alleged in Paragraph Three, have been and are now having the effects, among others, of:

(A) eliminating and preventing substantial competition between competitors and potential competitors in the operation of taxicabs in Minneapolis;

(B) strengthening the market power of currently authorized taxicab companies operating in the Minneapolis taxicab market;

(C) raising, fixing, stabilizing, maintaining, or otherwise interfering or tampering with the rates charged for taxicab service in and from Minneapolis; and

(D) depriving interstate and intrastate consumers of taxicab services in and from Minneapolis of the benefits of free and open competition in taxicab services.

PAR. 5. The acts and practices of Respondent, as alleged herein, were and are to the prejudice and injury of the public and constituted and constitute unfair methods of competition in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, as amended. The acts and practices, as herein alleged, are continuing and will continue in the absence of the relief herein requested.

STATEMENT OF CHAIRMAN JAMES C. MILLER III

After extensive consideration of the issue, I have voted today to issue complaints in accordance with my statutory responsibility to act when there is reason to believe that the law has been violated.

The action taken by the Commission today is based upon allegations of monopoly power and alleged violations of the U.S. antitrust laws in the taxi markets of Minneapolis and New Orleans [105 F.T.C. 1]. As a technical matter, the way a case is brought most effectively in such situations is to address regulations enacted by the city governments. I wish to stress that our concern is with allegations of monopoly power in taxi markets, and is not driven by any interest in limiting the lawfully-exercised powers of the cities themselves.

I also wish to stress that our concern is solely with restraints on *competition;* we have no concerns with rules affecting safety, insurance, and other related service standards.

The Commission's decision today comes after a 10-year staff study of taxi markets, after extensive inquiries and discussions with city officials and taxi operators, and after thorough briefing of the Commission by the agency's career staff.

STATEMENT OF COMMISSIONER MICHAEL PERTSCHUK* DISSENTING FROM THE ISSUANCE OF COMPLAINTS AGAINST THE CITIES OF MINNEAPOLIS AND NEW ORLEANS

I dissent from the Commission's decision to issue complaints against the cities of Minneapolis and New Orleans [105 F.T.C. 1] charging each city with an illegal combination or conspiracy in violation of the Sherman and FTC Acts. The complaints allege that each city conspired with taxicab owners and drivers to restrain trade in the provision of taxicab services through the enactment of municipal regulations that establish fixed taxi fares and create barriers to entry into the market.

For the Commission to succeed under the theories alleged in these complaints, it must first prove that the challenged regulations were the result of an illegal combination or conspiracy rather than lawful actions taken by the cities in the interest of their citizens. I am troubled by the idea that a city's adoption of taxi regulations after consultation with the industry—when consultation is a necessary element of responsible government—transforms the city's regulations into an illegal conspiracy.

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* Michael Pertschuk, Commissioner 1977–1984.

Second, when the federal antitrust laws come in apparent conflict with regulations enacted by a governmental entity such as a municipality, the Commission must be especially confident that federal intervention is warranted. Here it is at the very least unclear whether the economic theory of these complaints fits the facts as we know them. Studies commissioned by the Department of Transportation and others of cities where taxi service was deregulated do not demonstrate that the public benefited. Fares often rose and there is considerable doubt whether service improved. Finally, Congress is currently considering legislation which would exempt most municipal regulations from antitrust scrutiny. I note that the Assistant Attorney General in charge of the Antitrust Division has recently testified in support of that legislation. While the Commission need not consider pending legislation when deciding whether to act, the unpredictable effects of the Commission's action on the taxi market and the legitimate regulatory interests of the cities counsel restraint in these cases.

ORDER

Complaint counsel have moved for withdrawal of the complaint in this matter, on the ground that a new municipal ordinance that the City of Minneapolis recently enacted "significantly relieves the injury to competition alleged in the complaint and . . . may eliminate the need for further Commission action." The Administrative Law Judge has certified that motion to the Commission, with the recommendation that the Commission grant the motion. The complaint alleges that the City of Minneapolis has combined, contracted or agreed with taxicab companies in a number of respects relating to fare increases, fare uniformity, limitations on the number of taxicab licenses issued in Minneapolis, barriers to entry, and competition from vehicles-for-hire licensed outside Minneapolis, in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45. In the Notice of Contemplated Relief that accompanied the complaint, the Commission indicated that as part of any relief it might order, it might prohibit enforcement of three separate groups of Minneapolis Code provisions: (1) Section 341.710 *et seq.* (with some exceptions), which generally regulate fares; (2) portions of Section 341.260 and Section 341.280, which established a variety of criteria for determining whether new taxicab licenses should be issued; and (3) Section 341.300 and Section

341.310, which established 248 as the maximum number of taxicab licenses (other than 48 "winter licenses") available to operators in any given year.

The City of Minneapolis has now amended its Code to repeal Section 341.260 and Section 341.280. It has also amended Section 341.300 of the Code to raise the number of taxicab licenses from 248 to 323 by February 1, 1986, and by as many as an additional 25 licenses every year thereafter, beginning on July 1, 1986.[1] These changes offer the prospect of preventing the anticompetitive conduct alleged in the complaint by strongly facilitating new entry into the Minneapolis taxicab market. The Commission has therefore determined that continuing this matter would not presently serve the public interest, and that the complaint should be withdrawn. In taking this action, we express no opinion as to whether the liability of the City of Minneapolis could have been established at trial.

Accordingly, *it is ordered* that the complaint issued against the City of Minneapolis in Docket No. 9180 be, and it hereby is, withdrawn.

Commissioner Azcuenaga did not participate.

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[1] Section 341.290(b) has been amended to require that all license holders must be "a member of a company, cooperative, or association" with at least eight taxicabs licensed by Minneapolis; at least fifteen licensed taxicabs "operated under a common color scheme with common radio dispatching facilities;" and a total of at least fifteen such taxicabs licensed in Minneapolis within one year of issuance of the first eight licenses. Section 341.290(c) exempts taxicabs already holding licenses from this requirement.

IN THE MATTER OF

ASSOCIATED DRY GOODS CORPORATION

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT AND THE FAIR CREDIT REPORTING ACT

Docket C-3153. Complaint, May 7, 1985—Decision, May 7, 1985

This consent order requires a New York City merchandise retailer, among other things, to cease failing to disclose to an applicant who has been denied credit on the basis of information contained in a consumer report (including non-derogatory information or no file response), that the adverse action was based wholly or partly on information reported by a credit bureau; and provide rejected applicants with the name and address of the reporting agency. The order additionally requires that a copy of the letter attached to the order as Appendix A be completed to include the name and address of the appropriate consumer reporting agency, and mailed within 90 days to credit applicants who were denied credit by Robinson's of Florida or Hahne and Company, divisions of Associated Dry Goods Corporation, between January 1, 1982, and December 31, 1983, on the basis of information submitted by a consumer reporting company.

Appearances

For the Commission: *Paul K. Davis.*

For the respondents: *Joseph J. Schumm,* New York City.

COMPLAINT

Pursuant to the provisions of the Fair Credit Reporting Act and the Federal Trade Commission Act, and by virtue of the authority vested in it by said Acts, the Federal Trade Commission having reason to believe that Associated Dry Goods Corporation, a corporation, hereinafter referred to as respondent, has violated the provisions of said Acts, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint, stating its charges in that respect as follows:

PARAGRAPH 1. Respondent Associated Dry Goods Corporation is a corporation organized, existing and doing business under and by virtue of the laws of the Commonwealth of Virginia, with its office and principal place of business located at 417 Fifth Avenue, New York, New York.

Robinson's of Florida ("Robinson's") is a division of proposed respondent. Robinson's principal office and place of business is located at Tyrone Square, St. Petersburg, Florida.

Hahne and Company ("Hahne's") is also a division of proposed respondent. Hahne's principal office and place of business is located at 609 Broad Street, Newark, New Jersey.

PAR. 2. Respondent Associated Dry Goods Corporation, through its aforesaid Hahne's and Robinson's divisions, advertises, sells and distributes retail merchandise to the public.

PAR. 3. At all times relevant hereto, respondent in the course of business did and ordinarily does regularly extend and offer to extend consumer credit. In conjunction with the offer and extension of consumer credit, respondent has obtained and is obtaining "consumer reports" as that term is defined in Section 603(d) of the Fair Credit Reporting Act, 15 U.S.C. 1681a(d).

PAR. 4. Respondent maintains and has maintained a substantial course of business, including the acts and practices set forth herein, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act.

DEFINITIONS

For the purposes of this Complaint, the following definitions are applicable:

A. The terms *consumer*, *consumer report*, and *consumer reporting agency* shall be defined as provided in Sections 603(b), 603(d), and 603(f), respectively, of the Fair Credit Reporting Act, 15 U.S.C. 1681, 1681a(b), 1681a(d) and 1681a(f) (1970).

B. The term *no file response* shall be defined as a consumer report consisting of a response by a consumer reporting agency to respondent's request for information on a given applicant indicating that the consumer reporting agency has no credit history information in its files under the name and other identifiers supplied.

C. The term *non-derogatory information* shall be defined as information in a consumer report furnished to respondent by a consumer reporting agency, consisting of the presence of new credit accounts with credit histories too short to meet the respondent's criteria for granting credit, insufficient credit history, or insufficient credit file.

PART I

Alleging violations of the Fair Credit Reporting Act and of the Federal Trade Commission Act, the allegation of Paragraphs One through Four are incorporated by reference as if fully set forth verbatim.

PAR. 5. Respondent, through its divisions, in the ordinary course and conduct of its business, obtains and has obtained "consumer reports" from consumer reporting agencies. Respondent uses in whole or in part information contained in these reports to accept or deny applications for credit. In a substantial number of instances subsequent to January 1, 1982, respondent has denied consumers credit for personal, family, or household purposes based in whole or in part on non-derogatory information and "no file response" supplied by a consumer reporting agency. Although Robinson's of Florida and Hahne's advised the consumers that they were denied credit because they had no credit history, insufficient credit history, or insufficient credit file, in many instances, Robinson's of Florida and Hahne's failed to advise the consumer of the name and address of the consumer reporting agency making the report.

PAR. 6. By and through the use of the practices described in Paragraph Five, during the period of January 1, 1982, to December 31, 1983, Robinson's of Florida and Hahne's have denied applications for credit for personal, family or household use either wholly or partly because of information contained in a consumer report without advising the consumer of the name and address of the consumer reporting agency making the report. Therefore, respondent, through its divisions Robinson's of Florida and Hahne's, has violated the provisions of Section 615(a) of the Fair Credit Reporting Act.

PAR. 7. By its aforesaid failure to comply with Section 615(a) of the Fair Credit Reporting Act and pursuant to Section 621(a) thereof, respondent has thereby engaged in unfair and deceptive acts or practices in or affecting commerce in violation of Section 5(a)(1) of the Federal Trade Commission Act.

DECISION AND ORDER

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Atlanta Regional Office proposed to present to the Commission for its consideration and which, if issued by the Commission would charge respondent with violation of the Federal Trade Commission Act and the Fair Credit Reporting Act; and

The respondent, its attorney, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondent has violated the said Acts, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, now in conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings, and enters the following order:

1. Proposed respondent Associated Dry Goods Corporation is a corporation organized, existing and doing business under and by virtue of the laws of the Commonwealth of Virginia, with its office and principal place of business located at 417 Fifth Avenue, New York, New York.

Robinson's of Florida ("Robinson's") is a division of proposed respondent. Robinson's principal office and place of business is located at Tyrone Square, St. Petersburg, Florida.

Hahne and Company ("Hahne's") is also a division of proposed respondent. Hahne's principal office and place of business is located at 609 Broad Street, Newark, New Jersey.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and this matter is in the public interest.

ORDER

For the purposes of this Order the following definitions are applicable:

A. The terms *consumer, consumer report,* and *consumer reporting agency* shall be defined as provided in Sections 603(b), 603(d), and 603(f), respectively, of the Fair Credit Reporting Act, 15 U.S.C. 1681, 1681a(b), 1681a(d) and 1681a(f) (1970).

B. The term *no file response* shall be defined as a consumer report consisting of a response by a consumer reporting agency to respondent's request for information on a given applicant indicating that the consumer reporting agency has no credit history information in its files under the name and other identifiers supplied.

C. The term *non-derogatory information* shall be defined as information in a consumer report furnished to respondent by a consumer reporting agency, consisting of the presence of new credit accounts with credit histories too short to meet the respondent's criteria for granting credit, insufficient credit history, or insufficient credit file.

I.

It is ordered, That respondent Associated Dry Goods Corporation, a corporation, its successors and assigns, and its officers, agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with any application for credit that is primarily for personal, family or household purposes, do forthwith cease and desist from:

1. Failing, whenever credit for personal, family or household purposes involving a consumer is denied wholly or partly because of information contained in a consumer report from a consumer reporting agency (including non-derogatory information or no file response), to disclose to the applicant at the time the adverse action is communicated to the applicant (a) that the adverse action was based wholly or partly on information contained in such a report and (b) the name and address of the consumer reporting agency making the report.

2. Failing, within ninety (90) days after the date of service of this Order, to mail a copy of the letter attached hereto as Appendix A, completed to provide the name and address of the consumer reporting agency supplying the report, to each applicant who was denied credit by Robinson's of Florida or Hahne's between January 1, 1982, and December 31, 1983, based in whole or in part on information contained in a consumer report from a consumer reporting agency (including applicants denied credit based in whole or in part on non-derogatory information or no file response). The letter shall be sent by first class mail to the last known address of the applicant which is reflected in respondent's files. *Provided, however,* if the applicant was later extended credit or given the notice required by Section 615(a) of the Fair Credit Reporting Act, a copy of the letter attached as Appendix A need not be sent. Nothing in this Order shall prohibit respondent from adding to Appendix A a paragraph that resolicits the previously rejected applicants.

II.

It is further ordered, That respondent, its successors, and assigns shall maintain the following:

1. For at least two (2) years, documents that will demonstrate compliance with the requirements of Paragraph I.1. of this Order.

2. For at least three (3) years, documents that will demonstrate compliance with the requirements of Paragraph I.2. of this Order.

Upon request, such documents shall be made available to the Federal Trade Commission for inspection and copying. Such documents shall include, but are not limited to, all credit evaluation criteria instructions given to employees regarding compliance with the provisions of this Order, any notices provided to consumers pursuant to any provisions of this Order, and the complete application file to which they relate.

III.

It is further ordered, That Robinson's of Florida and Hahne's shall deliver a copy of this Order to all present employees engaged in reviewing or evaluating consumer reports in connection with applications for credit to be used for personal, family or household purposes. In addition, respondent shall deliver a copy of this Order to all present and future Directors of Credit of each division, at least once per year, for a period of four (4) years from the date of this Order.

IV.

It is further ordered, That respondent shall notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondent such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or divisions or any other change in the corporation which may affect compliance obligations arising out of the Order. This provision shall remain in effect for a period of four (4) years from the date of this Order.

V.

It is further ordered, That respondent, within one hundred fifty (150) days after service upon it of this Order, shall file with the Commission a report in writing setting forth in detail the manner and form in which it has complied with this Order.

APPENDIX A

Dear Customer:

Our records show that [Division of Associated Dry Goods] denied your application for consumer credit within the last four years. The Fair Credit Reporting Act gives persons denied consumer credit the right to know whether the denial was based on information supplied by a consumer reporting agency and, if so, the name and address of such agency. Credit reports provide a variety of information to creditors, including information about how many and what type of credit accounts you have.

Our records show that we may not have informed you that your [Division of Associated Dry Goods] application was denied because of information contained in a credit report. This report showed either no credit history or an insufficient credit record for you. The consumer reporting agency that furnished the report is:

____

[Name of Consumer Reporting Agency]

____

[Street Address]

If you want more information about the federal credit laws, write the Federal Trade Commission, Division of Credit Practices, Washington, D.C. 20580.

Thank you.

IN THE MATTER OF

YOUNG & RUBICAM/ZEMP, INC.

CONSENT ORDER, ETC. IN REGARD TO VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3154. Complaint, May 10, 1985—Final Order, May 10, 1985

This consent order requires a St. Petersburg, Fla. advertising agency, among other things, to cease, in connection with the advertising and sale of the Ecologizer CA/90 Series 2000 Air Treatment, representing falsely through the use of terms such as "eliminates," or by other means, that the portable household air cleaning appliance removes substantially all or most formaldehyde gas and tobacco smoke from the air people breathe under household living conditions. The order also bars the firm from misrepresenting the ability of any such appliance or equipment to clean the air of formaldehyde gas or tobacco smoke, and from representing the performance characteristics of any air cleaning appliance unless it possesses and relies upon competent and reliable substantiating evidence for such claims. Respondent is additionally required to cease failing to maintain written records of both substantiating materials and materials that contradict or qualify performance claims for a period of three years.

Appearances

For the Commission: *Judith Wilkenfeld*

For the respondent: *Sidney S. Rosdeitcher, Paul, Weiss, Rifkind, Wharton & Garrison,* Washington, D.C.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, as amended, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Young & Rubicam/Zemp, Inc., hereinafter referred to as respondent, has violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Respondent Young & Rubicam/Zemp, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of Florida, with its office and principal place of business located at 1213 16th Street North, St. Petersburg, Florida.

PAR. 2. Respondent was at all times relevant to this complaint an advertising agency of Rush-Hampton Industries, Inc.

PAR. 3. Respondent caused to be prepared and placed for publication and caused the dissemination of advertising and promotional material, including but not limited to the advertising referred to herein, to promote the sale of a portable, electric household air cleaning appliance, the Ecologizer CA/90 Series 2000 Air Treatment System (hereinafter referred to in the complaint as "air cleaning appliance").

PAR. 4. Respondent operates in various States of the United States and in the District of Columbia. Respondent's dissemination of advertisements for the air cleaning appliance mentioned herein constituted maintenance of a substantial course of trade in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act.

PAR. 5. In the course and conduct of its business and for the purpose of promoting the sale and distribution of household air cleaning appliances, respondent disseminated and caused the dissemination of advertising for household air cleaning appliances in national magazines, newspapers and catalogs distributed by the mail and across state lines, and in radio broadcasts transmitted by radio stations located in various States of the United States and in the District of Columbia, having sufficient power to carry such broadcasts across state lines. Respondent also placed air cleaning appliance advertisements with television stations having sufficient power to broadcast across state lines and into the District of Columbia. In addition, respondent distributed by mail or other means, product brochures and other sales literature directly to consumers or to dealers for display or distribution to consumers prior to or at the time of sale.

PAR. 6. Typical statements and representations in said advertisements and promotional materials, disseminated as previously described, but not necessarily inclusive thereof, are found in advertisements and promotional materials attached hereto as Exhibits A, B, C, D, E, F, G, H and I.

PAR. 7. Through the use of the statements and representations referred to in Paragraph Six, and other representations contained in advertisements and promotional materials not specifically set forth herein, respondent represented, directly or by implication, the following claims:

a. The air cleaning appliance "gets rid of" or eliminates formaldehyde gas and tobacco smoke from the air people breathe under household living conditions.

b. The air cleaning appliance cleans the air of or removes most formaldehyde gas and tobacco smoke from the air people breathe under household living conditions.

Par. 8. In truth and in fact, the direct or implied representations set forth in Paragraph Seven are false, for reasons including but not limited to the following:

a. The air cleaning appliance does not eliminate and does not remove most formaldehyde gas from the air people breathe under household living conditions. Tests conducted by Rush-Hampton Industries and independent tests, when extrapolated by generally accepted procedures to advertised room conditions, show that the air cleaning appliance optimally can remove no more than 5% of formaldehyde gas from the indoor air people breathe.

b. The air cleaning appliance does not eliminate and does not remove most tobacco smoke from the air people breathe under household living conditions. Independent tests, when extrapolated by generally accepted procedures to advertised room conditions, show that the air cleaning appliance optimally can remove no more than 15% of tobacco smoke from the indoor air people breathe.

Therefore, the direct or implied representations set forth in Paragraph Seven are false and misleading.

Par. 9. As the representations referred to above are false, and respondent knew or should have known that they were false at the time of their dissemination, such representations are deceptive, misleading, and unfair.

Par. 10. Through the use of the advertisements and promotional materials referred to in Paragraph Six, and other advertisements and promotional materials not specifically set forth herein, respondent represented, directly or by implication, that it possessed and relied upon a reasonable basis for the representations set forth in Paragraph Seven at the initial dissemination of the representations and each subsequent dissemination. In truth and in fact, respondent did not possess and rely upon a reasonable basis for making such representations, and respondent knew or should have known that it did not possess and rely upon a reasonable basis. Therefore, respondent's representations are false and misleading.

Par. 11. The use by respondent of the aforesaid false and misleading representations, and the placement in the hands of others of the means and instrumentalities by and through which others may use the aforesaid representations, had the capacity and tendency to mislead consumers into the erroneous and mistaken belief that said representations are true and complete and to induce such persons to purchase air cleaning appliances sold by Rush-Hampton Industries, Inc. by reason of said erroneous and mistaken belief.

Par. 12. The aforesaid acts and practices of respondent, as herein alleged, were all to the prejudice and injury of the public, and constituted unfair and deceptive acts or practices in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, as amended.

EXHIBIT A

TRANSCRIPT OF RADIO COMMERCIALS

1. "Socks"

A: Hello, this is Good Air Talk, you're on the air.
B: Good Air Talk.
A: Go ahead, sir, go ahead.
B: Listen, I have this great idea I want to talk to you about.
A: Well, does it have anything to do with good air?
B: Yes it does.
A: Okay, go ahead.
B: Well you know all the tobacco smoke, dust, odors and pollen in your indoor air?
A: You mean inside your house?
B: Right. What if somebody invented a thing to get rid of all that stuff?
A: They have sir. It is called the ECOLOGIZER*, it's an indoor air treatment system—
B: You know, something you just plug into the wall, I mean, with all the tobacco smoke—
A: Sir, it already exists. Its called the ECOLOGIZER*.
B: What do I know, maybe this thing could even get rid of unseen harmful gases?
A: You mean like formaldehyde and ammonia that you're probably breathing right now?
B: That's the idea.
A: Look, besides tobacco smoke, dust, odors and pollen, the ECOLOGIZER* with CA/90* also gets rid of those harmful gases. It's the only one that does. That's why it's worth more.
B: I'm no science guy, but I know that that technology has to exist.
A: Look, it does exist, sir, and its all in the ECOLOGIZER* CA/90*.
B: Now if you don't like this idea, here's another one.
A: Go ahead.
B: How come nobody's invented digital socks yet, I'm asking.
A: Look, you are just going to have to call Digital Socks Talk, okay?
B: How's that?
A: And that's it for Good Air Talk.
B: Hello?

ANNOUNCER:

Now get a bonus CA/90* filtering system with purchase of an ECOLOGIZER*

2. "Snooze"

A: Hello, this is Good Air Talk.
B: Is this Good Air Talk?
A: Good Air Talk—

---

* Registered trademark.

B: Now listen, give me one good reason to buy that ECOLOGIZER* air treatment system you always talk about.

A: Okay, CA/90*.

B: CA/90*?

A: Right, CA/90* is a powerful, natural ordor-absorbing substance that makes the ECOLOGIZER* better than anything else going.

B: You mean its better than—

A: Right.

B: Well what about—

A: It's much better. It's the only air treatment system that removes harmful gases.

B: Gases?

A: Right. Like formaldehyde and ammonia.

B: Formaldehyde? Hold on.

A: [Sotto voice] He's holding on.

B: I don't see any formaldehyde in here.

A: Of course you don't. But it's there.

B: Where?

A: In just about every indoor environment. You're probably breathing it right now.

B: You mean I'm breathing harmful gases right now?

A: Probably.

B: Boy, how can I get rid of them?

A: Listen to me. Get an ECOLOGIZER*. It's the only air treatment system with CA/90*.

B: And that'll get rid of indoor gases?

A: Right. Plus tobacco smoke, dust, odors and pollen.

B: Now listen, what does it cost?

A: Well, an ECOLOGIZER* costs a little bit more but, believe me, it's worth it.

B: Yeah. I know what you mean. I tried to save a few bucks once on a cheap alarm clock.

A: Uh-huh.

B: But every time I pushed the snooze alarm the clock fell asleep.

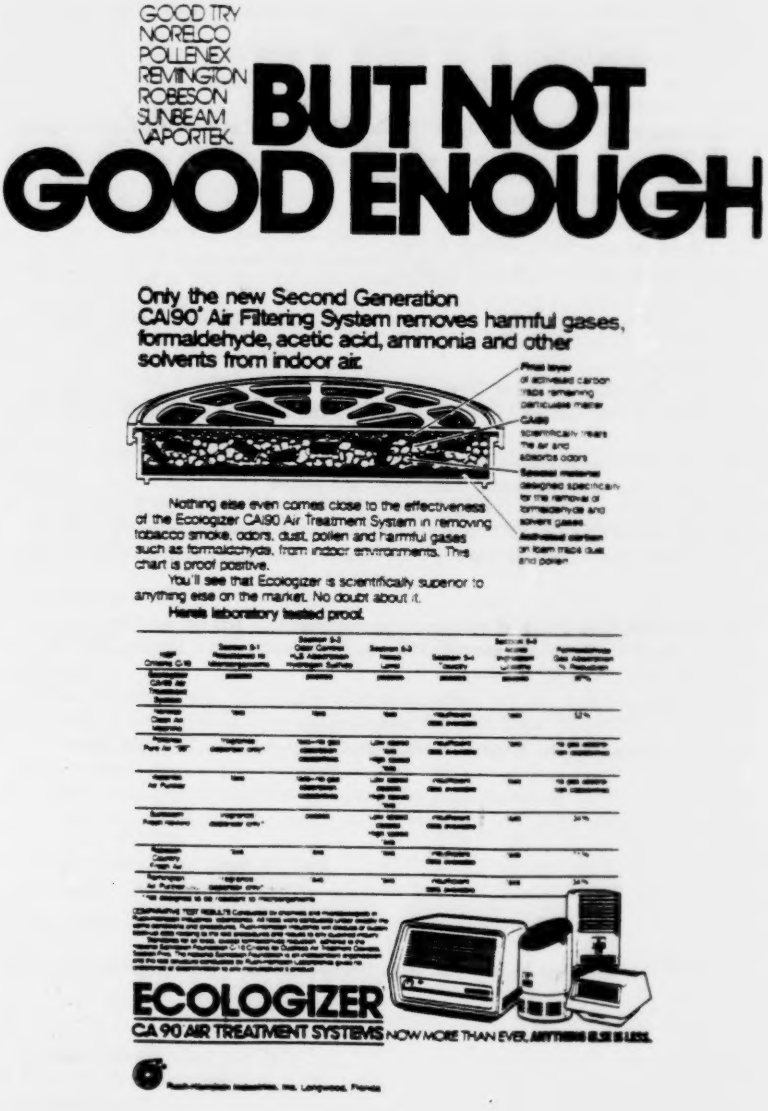
A: Yes, and that's it for Good Air Talk.

B: I like your show by the way.

ANNOUNCER:

Now get a bonus CA/90* filtering system with purchase of an ECOLOGIZER*.

EXHIBIT B



GOOD TRY
NORELCO
POLLENEX
REMINGTON
ROBESON
SUNBEAM
VAPORTEK

BUT NOT GOOD ENOUGH

Only the new Second Generation CA/90° Air Filtering System removes harmful gases, formaldehyde, acetic acid, ammonia and other solvents from indoor air.

First layer of activated carbon traps remaining particulate matter
CA/90 scientifically treats the air and absorbs odors
Special material designed specifically for the removal of formaldehyde and solvent gases
Activated carbon on foam traps dust and pollen

Nothing else even comes close to the effectiveness of the Ecologizer CA/90 Air Treatment System in removing tobacco smoke, odors, dust, pollen and harmful gases such as formaldehyde, from indoor environments. This chart is proof positive.

You'll see that Ecologizer is scientifically superior to anything else on the market. No doubt about it.

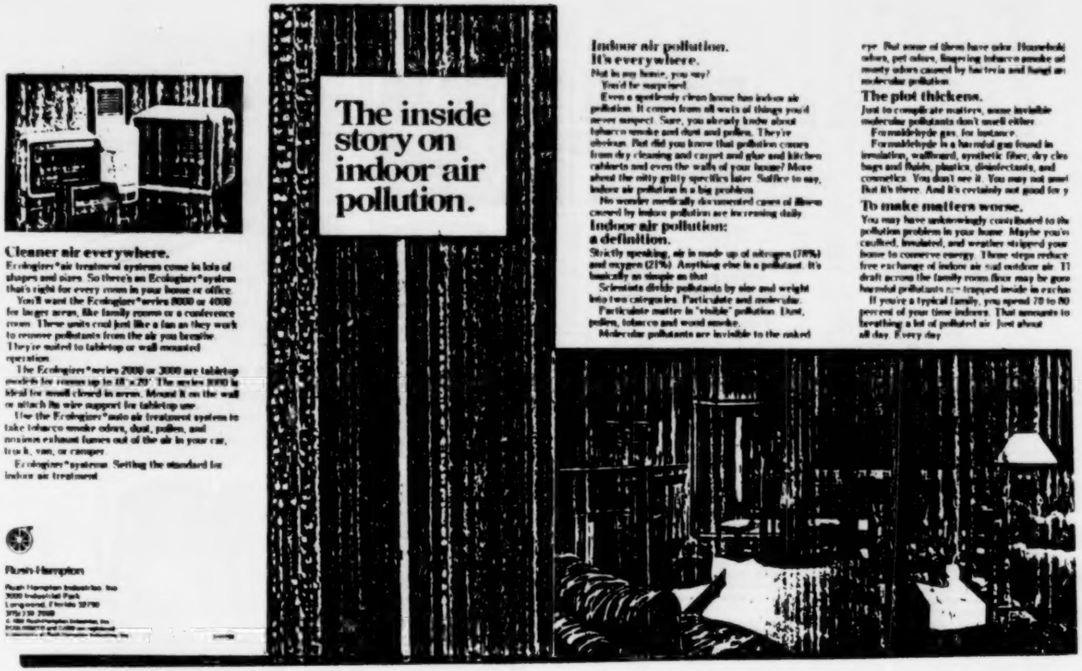
Here's laboratory tested proof.

ECOLOGIZER

CA 90° AIR TREATMENT SYSTEMS NOW MORE THAN EVER, **ANYTHING ELSE IS LESS.**

Rush-Hampton Industries, Inc. Longwood, Florida

EXHIBIT C



The inside story on indoor air pollution.

Indoor air pollution. It's everywhere.

Not in my home, you say?

You'd be surprised.

Even a spotlessly clean home has indoor air pollution. It comes from all sorts of things you'd never suspect. Sure, you already know about tobacco smoke and dust and pollen. They're obvious. But did you know that pollution comes from dry cleaning and carpet and glue and kitchen cabinets and even the walls of your house? More about the nitty gritty specifics later. Suffice to say, indoor air pollution is a big problem.

No wonder medically documented cases of illness caused by indoor pollution are increasing daily.

Indoor air pollution: a definition.

Strictly speaking, air is made up of nitrogen (78%) and oxygen (21%). Anything else is a pollutant. It's basically as simple as that.

Scientists divide pollutants by size and weight into two categories. Particulate and molecular.

Particulate matter is "visible" pollution. Dust, pollen, tobacco and wood smoke.

Molecular pollutants are invisible to the naked eye. But some of them have odor. Household odors, pet odors, lingering tobacco smoke and musty odors caused by bacteria and fungi are molecular pollution.

The plot thickens.

Just to complicate matters, some invisible molecular pollutants don't smell either.

Formaldehyde gas, for instance.

Formaldehyde is a harmful gas found in insulation, wallboard, synthetic fiber, dry cle bags and fluids, plastics, disinfectants, and cosmetics. You don't see it. You may not smel But it's there. And it's certainly not good for y

To make matters worse.

You may have unknowingly contributed to the pollution problem in your home. Maybe you've caulked, insulated, and weather stripped your home to conserve energy. These steps reduce free exchange of indoor air and outdoor air. T draft across the family room floor may be gone harmful pollutants are trapped inside in exchan

If you're a typical family, you spend 70 to 80 percent of your time indoors. That amounts to breathing a lot of polluted air. Just about all day. Every day.

Cleaner air everywhere.

Ecologizer* air treatment systems come in lots of shapes and sizes. So there's an Ecologizer* system that's right for every room in your house or office.

You'll want the Ecologizer* series 8000 or 4000 for larger areas, like the family room or a conference room. These units cool just like a fan as they work to remove pollutants from the air you breathe. They're suited to tabletop or wall mounted operation.

The Ecologizer* series 2000 or 3000 are tabletop models for rooms up to 18'×20'. The series 1000 is ideal for small closed in areas. Mount it on the wall or attach its wire support for tabletop use.

Use the Ecologizer* auto air treatment system to take tobacco smoke odors, dust, pollen, and noxious exhaust fumes out of the air in your car, truck, van, or camper.

Ecologizer* systems. Setting the standard for indoor air treatment.

Rush-Hampton

Rush-Hampton Industries, Inc.
3000 Industrial Park
Longwood, Florida 32750
[illegible] 7000
© [illegible] Rush-Hampton Industries, Inc.
[illegible] registered
trademarks of Rush-Hampton Industries, Inc.

Increased air flow.

By creating a constant flow of air from outside, you can reduce many common indoor pollution problems. Sometimes, however, you exchange polluted indoor air for polluted outdoor air. And, in all but the mildest climates, outside air flow is not always practical.

Eliminate the sources.

Restricting the use of certain chemicals and certain types of building materials could help. But it is virtually impossible to eliminate all pollution causing elements from our indoor environments.

'Maybe I'll just quit breathing.'

Well, that's one solution. But here's a better one: Ecologizer® air treatment systems.

They're the only systems that do the total indoor air treatment job. They continuously remove the undesirable stuff we've been talking about from the air you breathe. Things like odors, dust, pollen, and harmful gases.

Science not magic.

It wasn't easy to solve the tough problem of indoor air pollution. It's not as simple as taking a fan and putting it in a plastic housing as some air cleaner manufacturers have done.

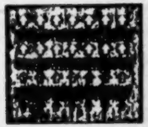
Development of the Ecologizer® systems took years of laboratory research. Ecologizer® systems are based on scientific principle.

Here's how they work.

Polluted air inside your house is drawn into the Ecologizer® system, where high density foam takes out most particulate matter – dust, pollen, ash, and fibers.

That's the easy part. Lots of air cleaners can more or less do that.

Then, the air passes through a layer of CARB® formula with activated carbon. Here's where the science comes in. The CARB® formula layer is unique to Ecologizer® systems. It's a powerful odor absorber with several unique air treatment properties. The CARB® formula layer even removes odors caused by harmful bacteria and fungi. A special gas absorbing material in this layer removes formaldehyde, ammonia, acetic acid, solvent gas, and others.



Then, our last pass through foam removes more particulate matter. Air comes out of the Ecologizer® system a whole lot cleaner. A whole lot fresher.

The other guys.

Of course there are other air cleaners on the market. At best, they offer half a solution. They may help reduce particulate matter or remove smoke only. But by and large they do nothing to eliminate harmful gases. The worst of the breed actually add to indoor air pollution by perfuming the air.

The big picture.

Here's a rundown, room by room, on the sources of indoor air pollution you could have in your home

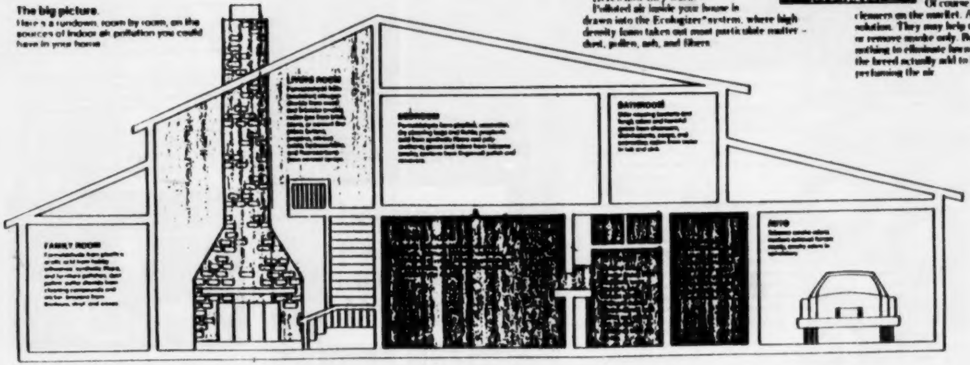
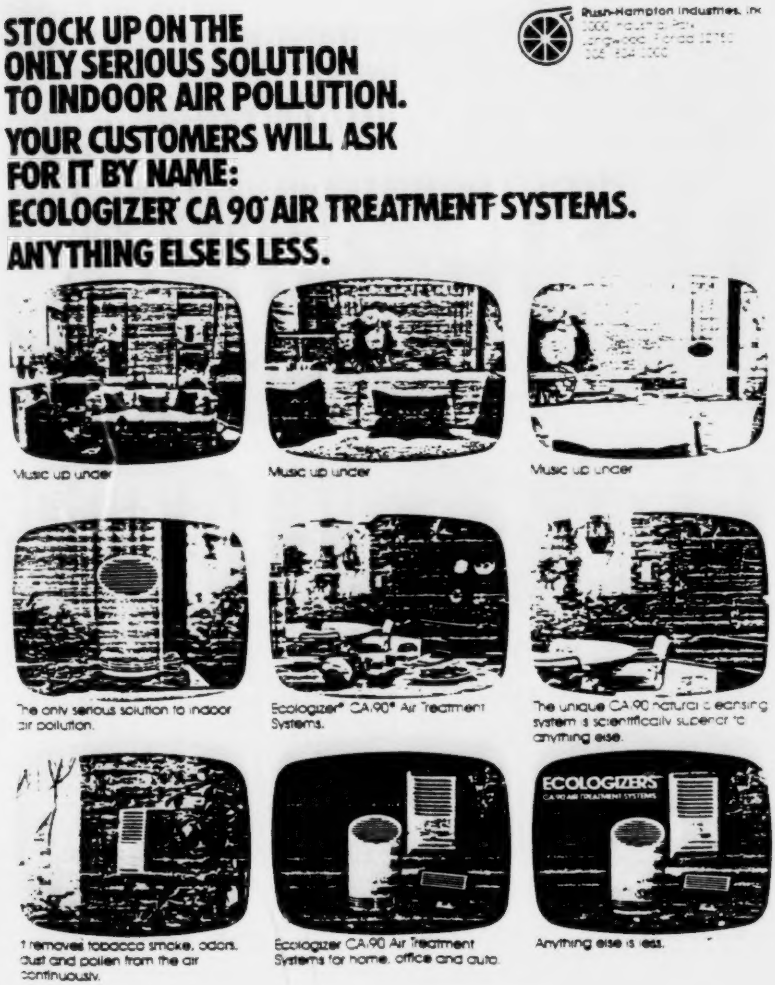


EXHIBIT D



Rush-Hampton Industries, Inc
2000 Industrial Park
Longwood, Florida 32750
305 834 2000

STOCK UP ON THE
ONLY SERIOUS SOLUTION
TO INDOOR AIR POLLUTION.
YOUR CUSTOMERS WILL ASK
FOR IT BY NAME:
ECOLOGIZER® CA 90® AIR TREATMENT SYSTEMS.
ANYTHING ELSE IS LESS.

Music up under

Music up under

Music up under

The only serious solution to indoor air pollution.

Ecologizer® CA/90® Air Treatment Systems.

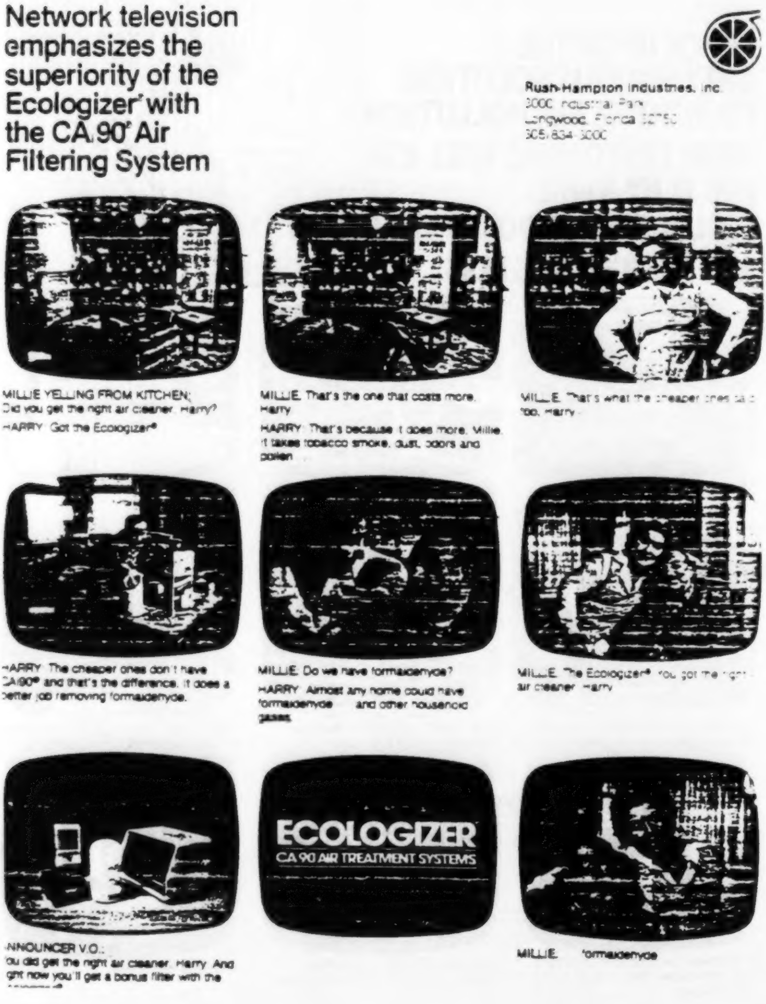
The unique CA/90 natural cleansing system is scientifically superior to anything else.

It removes tobacco smoke, odors, dust and pollen from the air continuously.

Ecologizer CA/90 Air Treatment Systems for home, office and auto.

Anything else is less.

EXHIBIT E



Network television emphasizes the superiority of the Ecologizer® with the CA/90® Air Filtering System

Rush-Hampton Industries, Inc.
3000 Industrial Park
Longwood, Florida 32750
305/834-3000

MILLIE YELLING FROM KITCHEN:
Did you get the right air cleaner, Harry?

HARRY: Got the Ecologizer®

MILLIE: That's the one that costs more, Harry.

HARRY: That's because it does more, Millie. It takes tobacco smoke, dust, odors and pollen . . .

MILLIE: That's what the cheaper ones said too, Harry.

HARRY: The cheaper ones don't have CA/90® and that's the difference. It does a better job removing formaldehyde.

MILLIE: Do we have formaldehyde?

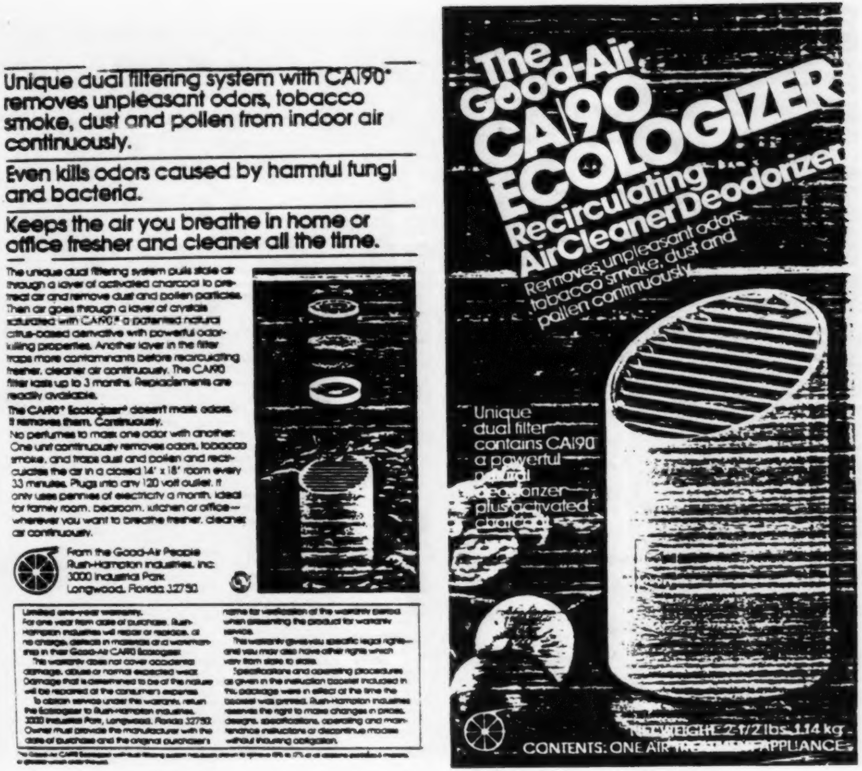
HARRY: Almost any home could have formaldehyde . . . and other household gases.

MILLIE: The Ecologizer®. You got the right air cleaner, Harry.

NNOUNCER V.O.:
ou did get the right air cleaner, Harry. And
ght now you'll get a bonus filter with the

MILLIE: . . . formaldehyde

EXHIBIT F



The Good-Air CA/90 ECOLOGIZER

Recirculating AirCleaner Deodorizer

Removes unpleasant odors, tobacco smoke, dust and pollen continuously

Unique dual filter contains CA/90 a powerful natural deodorizer plus activated charcoal

NET WEIGHT 2-1/2 lbs. 1.14 kg

CONTENTS: ONE AIR TREATMENT APPLIANCE

Unique dual filtering system with CA/90* removes unpleasant odors, tobacco smoke, dust and pollen from indoor air continuously.

Even kills odors caused by harmful fungi and bacteria.

Keeps the air you breathe in home or office fresher and cleaner all the time.

The unique dual filtering system pulls stale air through a layer of activated charcoal to pretreat air and remove dust and pollen particles. Then air goes through a layer of crystals saturated with CA/90,* a patented natural citrus-based derivative with powerful odor-killing properties. Another layer in the filter traps more contaminants before recirculating fresher, cleaner air continuously. The CA/90 filter lasts up to 3 months. Replacements are readily available.

The CA/90* Ecologizer* doesn't mask odors. It removes them. Continuously.

No perfumes to mask one odor with another. One unit continuously removes odors, tobacco smoke, and traps dust and pollen and recirculates the air in a closed 14' x 18' room every 33 minutes. Plugs into any 120 volt outlet. It only uses pennies of electricity a month. Ideal for family room, bedroom, kitchen or office—wherever you want to breathe fresher, cleaner air continuously.

From the Good-Air People
Rush-Hampton Industries, Inc.
3000 Industrial Park
Longwood, Florida 32750

Limited one-year warranty.

For one year from date of purchase, Rush-Hampton Industries will repair or replace, at no charge, defects in materials and workmanship in their Good-Air CA/90 Ecologizer.

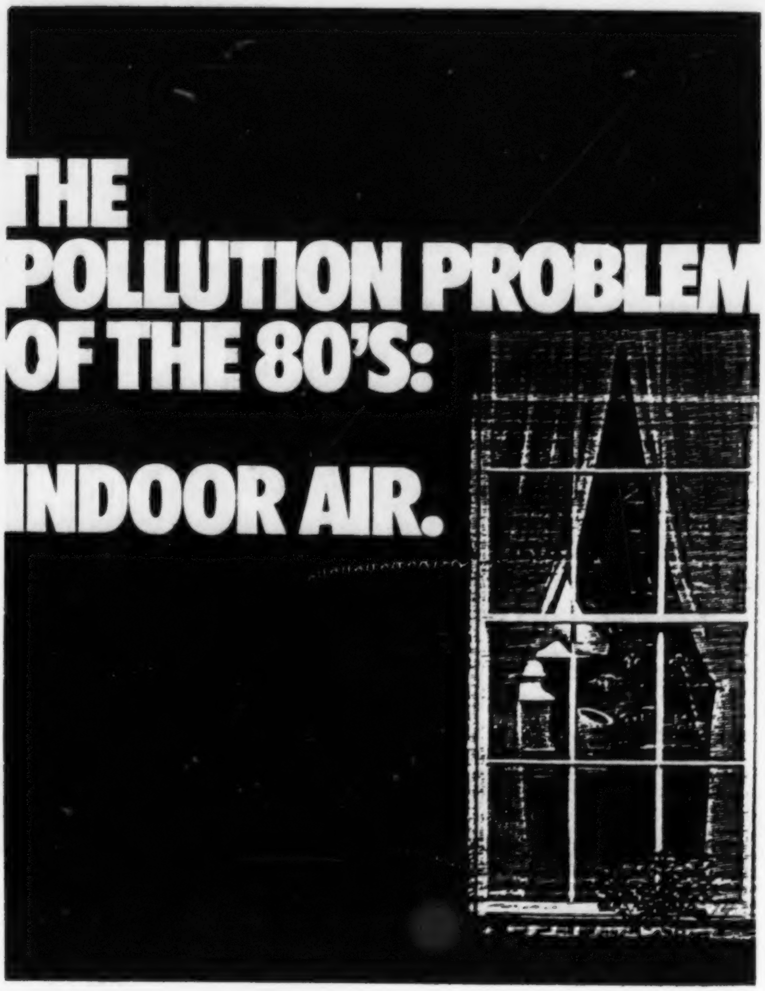
The warranty does not cover accidental damage, abuse or normal expected wear. Damage that is determined to be of this nature will be repaired at the consumer's expense.

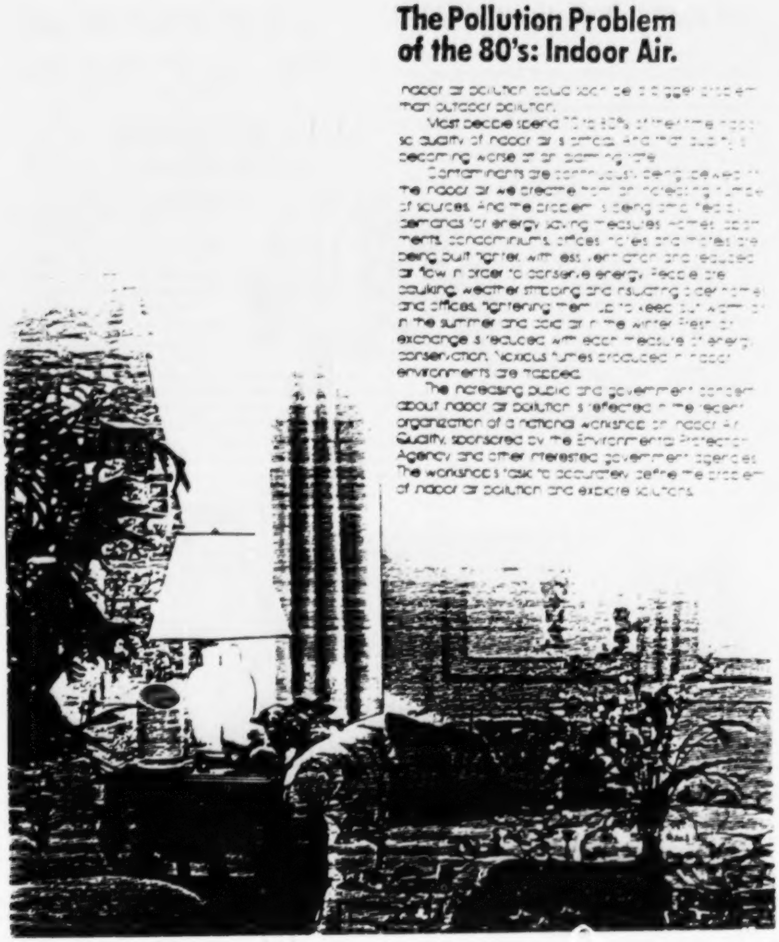
To obtain service under this warranty, return the Ecologizer to Rush-Hampton Industries, 3000 Industrial Park, Longwood, Florida 32750. Owner must provide the manufacturer with the date of purchase and the original purchaser's name for verification of the warranty period when presenting the product for warranty service.

This warranty gives you specific legal rights—and you may also have other rights which vary from state to state.

Specifications and operating procedures as given in the instruction booklet included in this package were in effect at the time the booklet was printed. Rush-Hampton Industries reserves the right to make changes in prices, designs, specifications, operating and maintenance instructions or discontinue models without incurring obligation.

EXHIBIT G


THE
POLLUTION PROBLEM
OF THE 80'S:
INDOOR AIR.



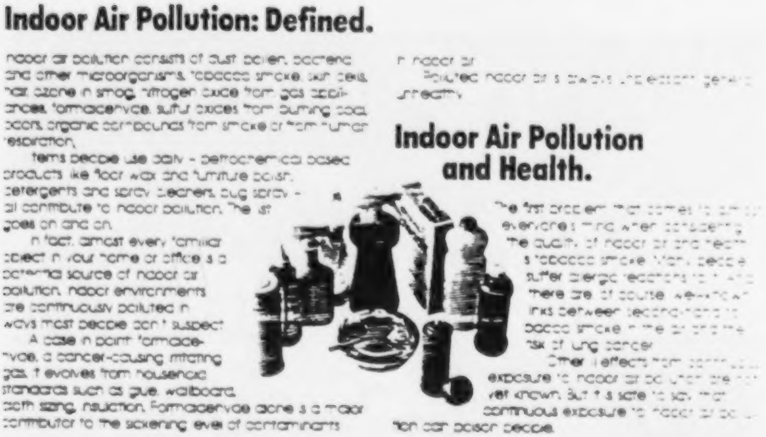
The Pollution Problem of the 80's: Indoor Air.

Indoor air pollution could soon be a bigger problem than outdoor pollution.

Most people spend 70 to 80% of their time indoors, so quality of indoor air is critical. And that quality is becoming worse at an alarming rate.

Contaminants are continuously being released into the indoor air we breathe from an increasing number of sources. And the problem is being amplified by demands for energy saving measures. Homes, apartments, condominiums, offices, hotels and motels are being built tighter, with less ventilation and reduced air flow in order to conserve energy. People are caulking, weather stripping and insulating older homes and offices, tightening them up to keep out warm air in the summer and cold air in the winter. Fresh air exchange is reduced with each measure of energy conservation. Noxious fumes produced in indoor environments are trapped.

The increasing public and government concern about indoor air pollution is reflected in the recent organization of a national workshop on Indoor Air Quality, sponsored by the Environmental Protection Agency and other interested government agencies. The workshop's task: to accurately define the problem of indoor air pollution and explore solutions.



Indoor Air Pollution: Defined.

Indoor air pollution consists of dust, pollen, bacteria and other microorganisms, tobacco smoke, skin cells, hair, ozone in smog, nitrogen oxide from gas appliances, formaldehyde, sulfur oxides from burning coal, odors, organic compounds from smoke or from human respiration.

Items people use daily – petrochemical based products like floor wax and furniture polish, detergents and spray cleaners, bug spray – all contribute to indoor pollution. The list goes on and on.

In fact, almost every familiar object in your home or office is a potential source of indoor air pollution. Indoor environments are continuously polluted in ways most people don't suspect.

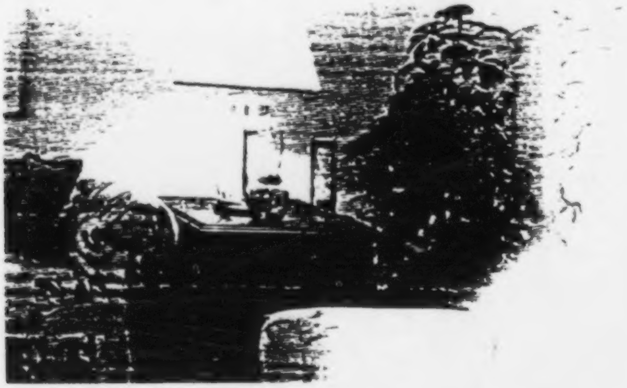
A case in point: formaldehyde, a cancer-causing irritating gas. It evolves from household standards such as glue, wallboard, cloth sizing, insulation. Formaldehyde alone is a major contributor to the sickening level of contaminants in indoor air.

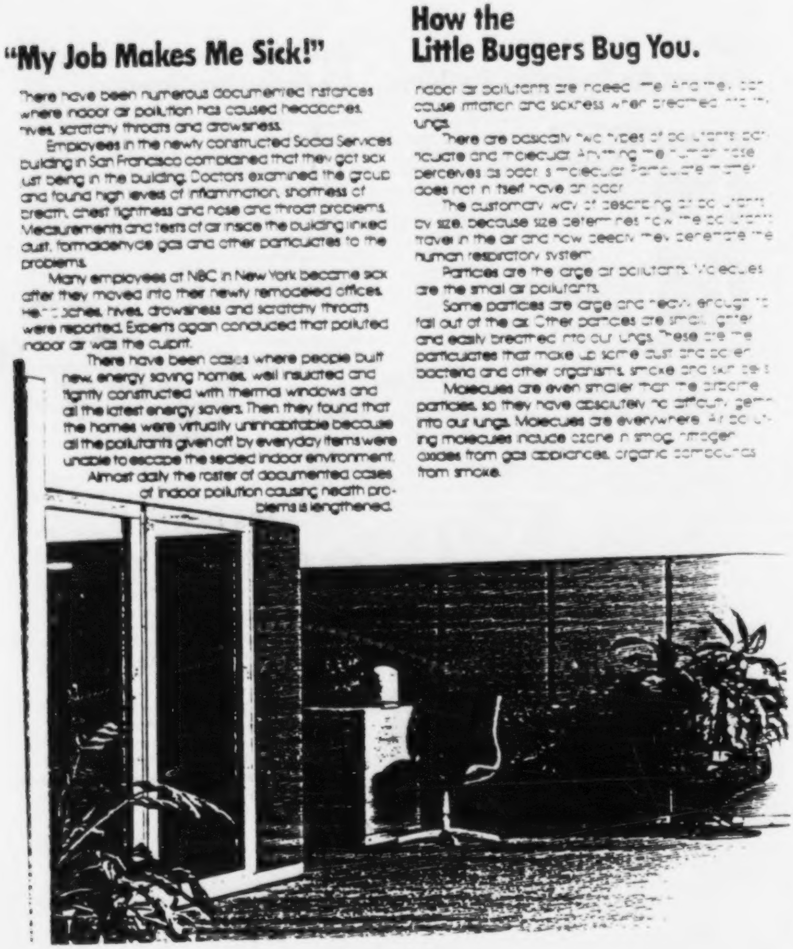
Polluted indoor air is always unpleasant, generally unhealthy.

Indoor Air Pollution and Health.

The first problem that comes to almost everyone's mind when considering the quality of indoor air and health is tobacco smoke. Many people suffer allergic reactions to it. And there are, of course, well-known links between secondhand tobacco smoke in the air and the risk of lung cancer.

Other ill effects from continuous exposure to indoor air pollution are not yet known. But it's safe to say that continuous exposure to indoor air pollution can poison people.





"My Job Makes Me Sick!"

There have been numerous documented instances where indoor air pollution has caused headaches, hives, scratchy throats and drowsiness.

Employees in the newly constructed Social Services building in San Francisco complained that they got sick just being in the building. Doctors examined the group and found high levels of inflammation, shortness of breath, chest tightness and nose and throat problems. Measurements and tests of air inside the building linked dust, formaldehyde gas and other particulates to the problems.

Many employees at NBC in New York became sick after they moved into their newly remodeled offices. Headaches, hives, drowsiness and scratchy throats were reported. Experts again concluded that polluted indoor air was the culprit.

There have been cases where people built new, energy saving homes, well insulated and tightly constructed with thermal windows and all the latest energy savers. Then they found that the homes were virtually uninhabitable because all the pollutants given off by everyday items were unable to escape the sealed indoor environment.

Almost daily the roster of documented cases of indoor pollution causing health problems is lengthened.

How the Little Buggers Bug You.

Indoor air pollutants are indeed little. And they can cause irritation and sickness when breathed into the lungs.

There are basically two types of pollutants: particulate and molecular. Anything the human nose perceives as odor is molecular. Particulate matter does not in itself have an odor.

The customary way of describing air pollutants by size, because size determines how the pollutants travel in the air and how deeply they penetrate the human respiratory system.

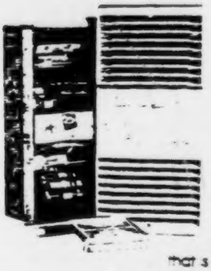
Particles are the large air pollutants. Molecules are the small air pollutants.

Some particles are large and heavy enough to fall out of the air. Other particles are small, lighter and easily breathed into our lungs. These are the particulates that make up some dust and pollen, bacteria and other organisms, smoke and skin cells.

Molecules are even smaller than the airborne particles, so they have absolutely no difficulty getting into our lungs. Molecules are everywhere. Air polluting molecules include ozone in smog, nitrogen oxides from gas appliances, organic compounds from smoke.

best copy available

Solving the Indoor Air Pollution Problem.

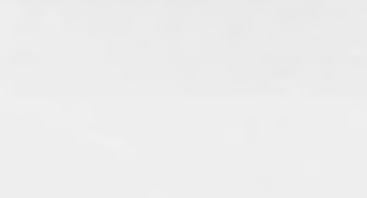


Obviously, indoor air pollution is a problem of increasing magnitude that affects the quality of everyone's life. It's a problem that needs to be addressed and solved. Quickly.

One solution would be to see that all living and work areas are properly ventilated. However, in many situations that is simply not possible nor practical.

Another solution is to use air treatment devices such as the Rush-Hampton CA/90® Air Treatment System.

The Ecologizer® CA/90 Air Treatment Systems are appliances designed for home, office and auto use. The Ductless Fan CA/90 Air Treatment System is built-in during new construction or remodeling. It's the only building-code approved ductless fan – the only one that meets C-10 criteria.

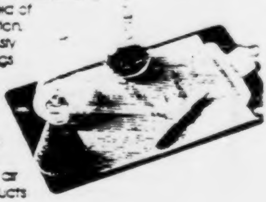


Rush-Hampton: The Indoor Air Pollution Experts.

Although the problem of indoor air pollution has been with us for years, it's only recently come to the attention of the public. Consequently, few people have seriously studied the problem and are fully knowledgeable in the field.

Rush-Hampton Industries is one of the few.

Rush-Hampton has a clear understanding of indoor air pollution. Since 1969 our chemists have been doing extensive research and testing in the field of indoor air pollution. From meticulously recorded findings accumulated through years of scientific study, we have developed and marketed a broad range of air treatment products and systems.



CA 90. The Key.

CA/90 is a patented chemical developed by Rush-Hampton Industries' scientists. It's a natural derivative of citrus with unique odor-control and air treatment properties.

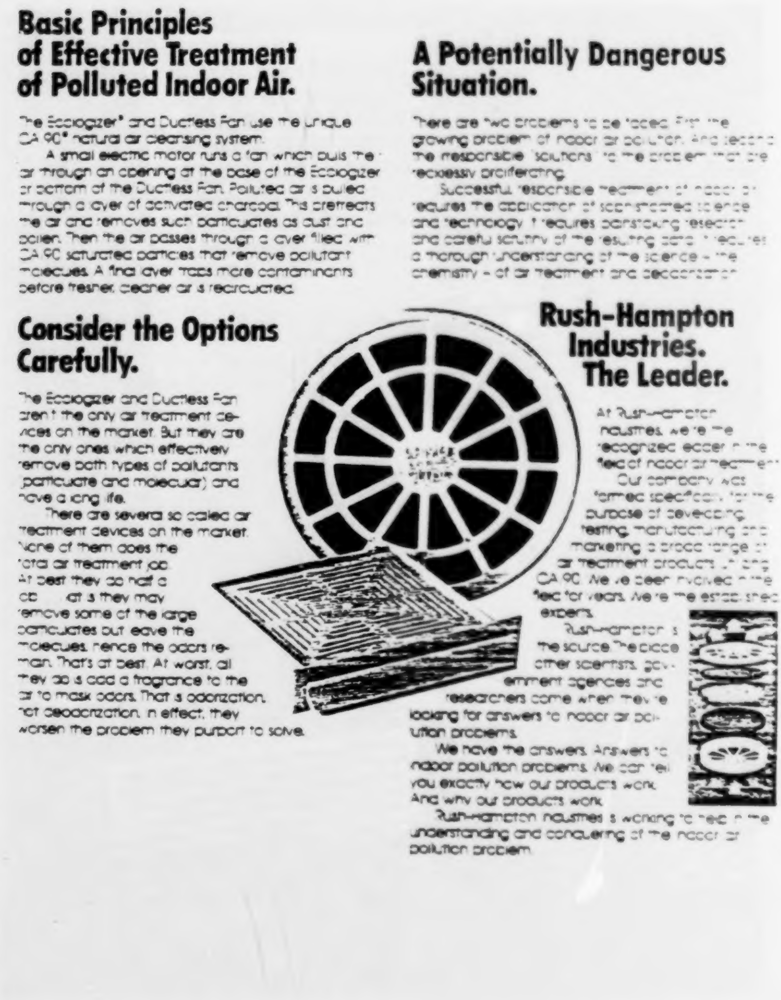
Here's how it works to rid the air of odors.

As you remember, odors are made of molecules. There are ways of what chemists refer to as "scrubbing" molecules from the air. CA/90 can perform several of the known methods.

Adsorption. The CA/90 surface is highly attractive to molecules. They actually stick to it.

Dissolution. CA/90 provides a solvent that dissolves molecules.

Chemical Change. CA/90 chemically changes molecules to non-volatile innocuous substances.



Basic Principles of Effective Treatment of Polluted Indoor Air.

The Ecologizer® and Ductless Fan use the unique CA 90® natural air cleansing system.

A small electric motor runs a fan which pulls the air through an opening at the base of the Ecologizer or bottom of the Ductless Fan. Polluted air is pulled through a layer of activated charcoal. This prefilters the air and removes such particulates as dust and pollen. Then the air passes through a layer filled with CA 90 saturated particles that remove pollutant molecules. A final layer traps more contaminants before fresher, cleaner air is recirculated.

Consider the Options Carefully.

The Ecologizer and Ductless Fan aren't the only air treatment devices on the market. But they are the only ones which effectively remove both types of pollutants (particulate and molecular) and have a long life.

There are several so called air treatment devices on the market. None of them does the total air treatment job. At best they do half a job. That is they may remove some of the large particulates but leave the molecules, hence the odors remain. That's at best. At worst, all they do is add a fragrance to the air to mask odors. That is odorization, not deodorization. In effect, they worsen the problem they purport to solve.

A Potentially Dangerous Situation.

There are two problems to be faced. First, the growing problem of indoor air pollution. And second, the irresponsible "solutions" to the problem that are recklessly proliferating.

Successful, responsible treatment of indoor air requires the application of sophisticated science and technology. It requires painstaking research and careful scrutiny of the resulting data. It requires a thorough understanding of the science – the chemistry – of air treatment and deodorization.

Rush-Hampton Industries. The Leader.

At Rush-Hampton Industries, we're the recognized leader in the field of indoor air treatment.

Our company was formed specifically for the purpose of developing, testing, manufacturing and marketing a broad range of air treatment products utilizing CA 90. We've been involved in the field for years. We're the established experts.

Rush-Hampton is the source. The place other scientists, government agencies and researchers come when they're looking for answers to indoor air pollution problems.

We have the answers. Answers to indoor pollution problems. We can tell you exactly how our products work. And why our products work.

Rush-Hampton Industries is working to help in the understanding and conquering of the indoor air pollution problem.

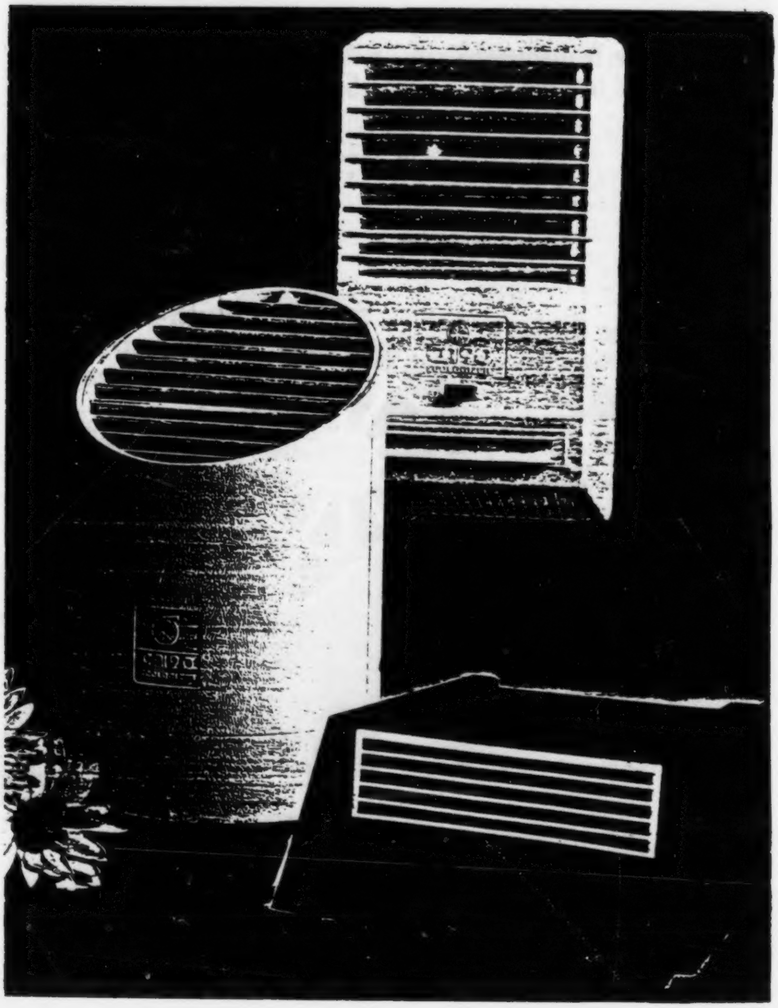
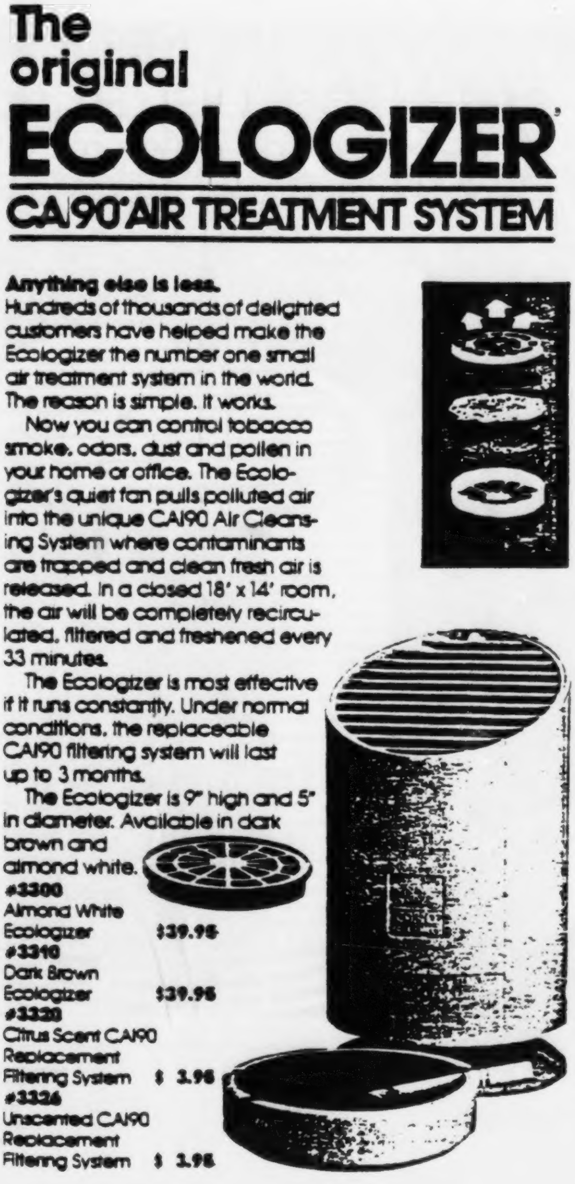


EXHIBIT H



The original ECOLOGIZER®

CA/90® AIR TREATMENT SYSTEM

Anything else is less.
Hundreds of thousands of delighted customers have helped make the Ecologizer the number one small air treatment system in the world. The reason is simple. It works.

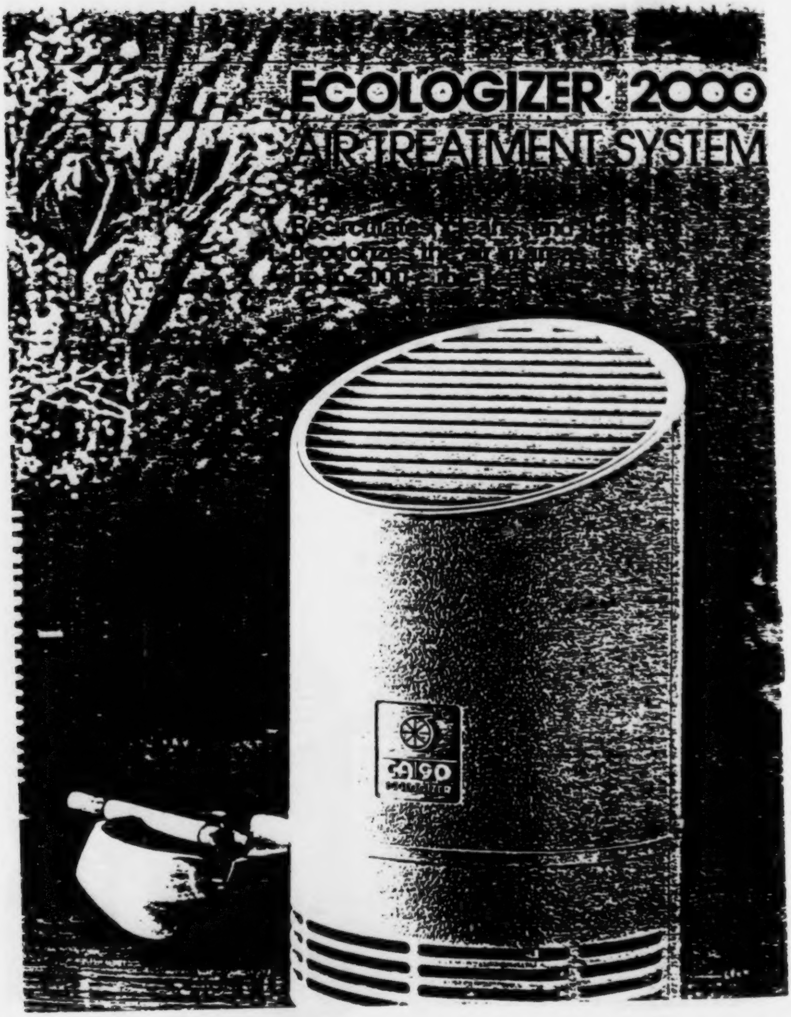
Now you can control tobacco smoke, odors, dust and pollen in your home or office. The Ecologizer's quiet fan pulls polluted air into the unique CA/90 Air Cleansing System where contaminants are trapped and clean fresh air is released. In a closed 18' x 14' room, the air will be completely recirculated, filtered and freshened every 33 minutes.

The Ecologizer is most effective if it runs constantly. Under normal conditions, the replaceable CA/90 filtering system will last up to 3 months.

The Ecologizer is 9" high and 5" in diameter. Available in dark brown and almond white.

#3300 Almond White Ecologizer	**$39.95**
#3310 Dark Brown Ecologizer	**$39.95**
#3320 Citrus Scent CA/90 Replacement Filtering System	**$ 3.95**
#3326 Unscented CA/90 Replacement Filtering System	**$ 3.95**

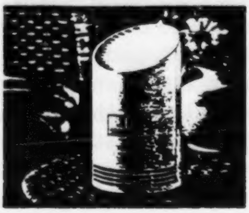
EXHIBIT I

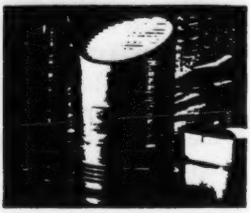

ECOLOGIZER 2000
AIR TREATMENT SYSTEM

Unsurpassed air treatment and odor control in home or office.

The Ecologizer® series 2000 air treatment system is perfect for home or office use. It utilizes the most effective filtering system available—the second generation filtering system with CAI90® advanced scientific formula.

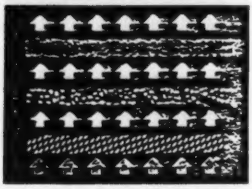
One unit continuously recirculates, treats, cleans, and deodorizes the air in areas up to 2000 cubic feet. And the Ecologizer® system is portable, so it can be used wherever effective odor control and air treatment are needed.





Second generation filtering system removes harmful gases and solvents, plus household odors, tobacco smoke odors, dust, and pollen.

This unique filtering system is composed of individual filtering layers—each performing a specific air treatment function. As polluted air is pulled into the unit, high-density foam pretreats the air and removes dust and pollen particles. An intermediate layer of CAI90® formula treats the air and removes odors—even odors caused by harmful bacteria and fungi. This layer also contains a special gas absorbing material that absorbs harmful gases found in everyday indoor environments, including formaldehyde, ammonia, acetic acid, and solvent gases. A final filtering layer traps even more contaminants before fresher, cleaner air is recirculated.

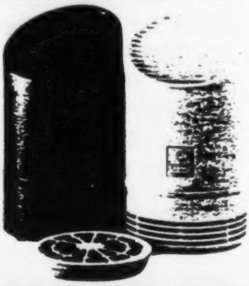


Together, these specialized filtering layers do the total indoor air treatment job. And the filtering system keeps its effectiveness for months.

Special features. Appealing colors.

The Ecologizer® system is available in light beige or brown, colors that complement any decor. The unit features a convenient on/off switch that allows the unit to be run only when needed.

The top of the unit separates from the bottom for quick and easy replacement of the filtering system. And to keep the Ecologizer® system working at its best, a special filter life indicator is included. Affixed to the unit or filtering system, the indicator changes color when it's replacement time.



Model 7305 (Light Beige)
Model 7315 (Brown)

ECOLOGIZER® 2000
AIR TREATMENT SYSTEM

Rush-Hampton Industries, Inc.
3000 Industrial Park
Longwood, Florida 32750
305/834-3000

©, 1982 Rush-Hampton Industries, Inc.
ECOLOGIZER and CAI90 are [illegible]

The Ecologizer® series 2000 air treatment system has been shown to remove greater than 50% of

DECISION AND ORDER

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondent with violation of the Federal Trade Commission Act; and

The respondent, its attorney, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondent has violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Young & Rubicam/Zemp, Inc. is a corporation organized, existing and doing business under and by virtue of the laws of the State of Florida, with its office and principal place of business located at 1213 16th Street North, St. Petersburg, Florida.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

ORDER

PART I

It is ordered, That respondent Young & Rubicam/Zemp, Inc., a corporation, its successors and assigns, and its officers, agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the advertising, offering for sale, sale or distribution of the Ecologizer CA/90 Series 2000 Air Treatment System, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

A. Representing, directly or by implication, contrary to fact, that the Ecologizer CA/90 Series 2000 Air Treatment System removes substantially all formaldehyde gas or tobacco smoke from the air people breathe under household living conditions through the use of the word "eliminates" or other phrases that the reasonable consumer would interpret as "substantially all."

B. Representing, directly or by implication, contrary to fact, that the Ecologizer CA/90 Series 2000 Air Treatment System cleans the air of or removes most formaldehyde gas or tobacco smoke from the air people breathe under household living conditions.

PART II

It is further ordered, That respondent, its successors and assigns, and its officers, agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the advertising, offering for sale, sale or distribution of the Ecologizer CA/90 Series 2000 Air Treatment System or any other air cleaning appliance or equipment, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from misrepresenting in any manner, directly or by implication, the ability of any such appliance or equipment to clean the air of or remove formaldehyde gas or tobacco smoke.

PART III

A. *It is further ordered,* That respondent, its successors and assigns, and its officers, agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the advertising, offering for sale, sale or distribution of the Ecologizer CA/90 Series 2000 Air Treatment System or any other air cleaning appliance or equipment, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from representing, directly or by implication, the performance characteristics of any such appliance or equipment unless respondent possesses and relies upon a reasonable basis for such representation, consisting of competent and reliable evidence which substantiates such representation.

B. To the extent the evidence of a reasonable basis consists of scientific or professional tests, experiments, analyses, research, studies or other evidence based on the expertise of professionals in the relevant area, such evidence shall be "competent and reliable" for purposes of Part III(A) only if those tests, experiments, analyses, research, studies, or other evidence are conducted and evaluated in an objective manner by persons qualified to do so, using procedures generally accepted in the profession or science to yield accurate and reliable results.

C. For purposes of Part III(A) of this order, the term "performance characteristics" means the cleaning, filtration, or removal ability of the appliance or equipment, with respect to formaldehyde gas or tobacco smoke, whether expressed in terms of the filtering media or mechanism, or in terms of the appliance itself.

Provided, however, That in circumstances where the scientific or professional tests, experiments, analyses, research, studies, or any other evidence based on the expertise of professionals in the relevant area was not directly or indirectly prepared, controlled, or conducted by respondent, it shall be an affirmative defense to an alleged violation of Part III of this Order for respondent to prove that it reasonably relied on the expert judgment of its client or of an independent third party in concluding that it had a reasonable basis in accordance with Part III of this Order. Such expert judgment shall be contained in a written document prepared by a person qualified by education or experience to render the opinion. Such opinion shall describe the contents of such evidence upon which the opinion is based.

Provided further, That nothing in this Order shall be deemed to deny or limit respondent with respect to any right, defense, or affirmative defense to which respondent otherwise may be entitled by law in a compliance action or any other action, including any right, defense, or affirmative defense based upon the legal standards applicable to advertising agencies.

PART IV

It is further ordered, That respondent, its successors and assigns, and its officers, agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the advertising, offering for sale, sale or distribution of any air cleaning appliance or equipment, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from failing to maintain written records:

1. Of all materials that were relied upon in disseminating any representation covered by this Order, insofar as the text of such representation is prepared, authorized, or approved by any person who is an officer or employee of respondent, or of any division, subdivision or subsidiary of respondent.

2. Of all test reports, studies, surveys, or demonstrations in its

possession or control that contradict, qualify, or call into question any representation made by respondent that is covered by this Order.

Such records shall be retained by respondent for a period of three years from the date the representations to which they pertain were last disseminated, and may be inspected by the staff of the Commission upon reasonable notice.

PART V

It is further ordered, That respondent shall forthwith distribute a copy of this Order to each of its operating divisions and to each of its officers, agents, representatives or employees engaged in the preparation and placement of advertisements or other sales materials.

PART VI

It is further ordered, That respondent notify the Commission at least thirty (30) days prior to the effective date of any proposed change in the corporate respondent such as dissolution, assignment or sale, resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporation which may affect compliance obligations arising out of this Order.

PART VII

It is further ordered, That respondent shall, within sixty (60) days after this order becomes final and binding, file with the Commission a report in writing, setting forth in detail the manner and form in which it has complied with the order.

IN THE MATTER OF

WARNER COMMUNICATIONS, INC., ET AL.

Docket 9174. Interlocutory Order, May 24, 1985.

ORDER

Respondents have filed several motions requesting that this matter be terminated, either by dismissal of the complaint or by consideration and eventual acceptance of a proposed consent agreement.

In disposition of these and related motions *it is hereby ordered* as follows:

1. Respondents' application pursuant to Section 3.23(b) of the Commission's Rules for review of the administrative law judge's order of March 27, 1985, is granted.

2. Respondents' motion to dismiss the complaint is denied. Section 7 of the Clayton Act, 15 U.S.C. 18, prohibits acquisitions having certain anticompetitive effects. The Commission is empowered by Section 11 of the Clayton Act, 15 U.S.C. 21, to enforce compliance with Section 7. The Commission is similarly empowered by 15 U.S.C. 45(a) to enforce compliance with the FTC Act. The complaint in this case alleges that the acquisition proposed by the respondents would violate these statutes. The fact that the respondents have not consummated their proposed transaction, and claim to have abandoned it, does not oust this statutory grant of jurisdiction. The Commission's subject-matter jurisdiction depends on the nature of the alleged illegal conduct, and not on whether it is ongoing at any particular point during the trial. To hold otherwise would mean that a Commission law enforcement action could be brought to a halt at any time, even after a complaint and injunction have issued, by an abandonment, even a temporary one, of the challenged conduct. The cases indicate that voluntary cessation of unlawful activity is not a basis for halting a law enforcement action. *See United States v. Concentrated Phosphate Export Ass'n*, 393 U.S. 199 (1968); *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290, 309 (1897) (Sherman Act cases). Indeed, Section 13(b) of the Clayton Act, 15 U.S.C. 53(b), expressly contemplates adjudication of the merits of the legality of unconsummated mergers when it provides for enjoining a proposed merger pending administrative hearings. And, in fact, the consummation of this transaction has been preliminarily enjoined pursuant to Section 13(b) pending Commission adjudication of the matter. *FTC v. Warner Communications, Inc.*, 742 F.2d 1156 (9th Cir. 1984).

The nonconsummation of the proposed transaction does not affect the Commission's subject-matter jurisdiction, but it may on an appropriate showing justify a conclusion that the matter is moot. Here, however, the claim that the allegedly unlawful transaction has been abandoned does not make the matter moot. At a minimum, questions of fact remain which prevent us from concluding that "it [is] absolutely clear that the allegedly wrongful behavior could not reasonably be expected to recur," in either identical or functionally-equivalent form. *United States v. Phosphate Export Ass'n, supra,* 393 U.S. at 203; *see United States v. W.T. Grant Co.,* 345 U.S. 629 (1953).

Respondents' additional arguments for dismissal are not persuasive. First, we believe that complaint counsel's demand for a prior-approval term in any final order is not made inappropriate by the Hart-Scott-Rodino Act, since that statute was intended only to ensure that the enforcement agencies receive prior notice of mergers, and nothing in its legislative history suggests that it was intended to supersede the use of fencing-in provisions imposed after a merger has actually been found improper. Second, while we express no view as to the appropriate remedy in this case, we see nothing requiring dismissal in the fact that complaint counsel have offered to settle on terms that were more or less favorable to respondents at different stages of the litigation, since any settlement offer will reflect the party's assessment of the strength of his case as of that particular point in the trial. Finally, we find that continuation of the administrative hearings would be in the public interest, because, as we have said, there exist substantial questions of fact as to the risk that a violation may recur.

Nothing in this order, however, precludes the administrative law judge from subsequently concluding on an appropriate showing that mootness has been demonstrated or that relief is unnecessary. *See United States v. Phosphate Export Ass'n, supra,* 393 U.S. at 203–04.

3. Respondents' motion to withdraw this matter from adjudication for consideration of a proposed consent agreement pursuant to Section 3.25(d) of the Commission's Rules is denied. Because the proposed settlement is on terms significantly different from the terms of Commission orders in similar cases, and because questions of fact concerning appropriate remedy remain, we are not satisfied that there is a likelihood of settlement on the terms proposed.

4. Respondents' motion for leave to reply to complaint counsel's answer to respondents' motion for dismissal of the complaint is granted.

5. Complaint counsel's motion for leave to reply to the motion of respondents to withdraw this matter from adjudication was filed with the Commission on March 25, 1985. A motion for leave to file a statement of Bureau of Competition Director Timothy J. Muris was filed

with the Commission on April 18, 1985, with the statement attached. The second motion sought leave to address the same questions as the first. Because the Bureau Director is the chief counsel supporting the complaint, we have treated the second motion as a duplicate of the first, which we have granted, and we have treated the statement attached to the second motion as complaint counsel's reply.

6. Respondents' request that their opposition to the motion for leave to file statement of Bureau Director Timothy Muris be considered as a response to that statement is granted.

7. The administrative law judge is directed to terminate the stay of the adjudicative hearing without unnecessary delay.

It is so ordered.

IN THE MATTER OF

GREAT LAKES CARBON CORPORATION, ET AL.

MODIFYING ORDER IN REGARD TO ALLEGED VIOLATION OF THE FEDERAL TRADE COMMISSION ACT

Docket 8805. Final Order, June 5, 1973—Modifying Order, June 4, 1985

This order reopens the proceeding and modifies the Commission's order issued on June 5, 1973 (82 F.T.C. 1529) to provide that the order, which was scheduled to expire in June of 1993, will terminate immediately upon entry of the modifying order. After considering respondent's petition requesting termination of the 1973 order, together with other relevant information, the Commission determined that the requested modification would serve the public interest. Changes in the market indicated that the order, which among other things required the companies to restrict their contracts for the purchase and sale of industrial quality petroleum coke to terms of three years, was no longer neccessary and impeded the ability of respondent companies to compete effectively.

ORDER REOPENING AND MODIFYING ORDER ISSUED JUNE 5, 1973

By a petition filed on January 3, 1985, respondent Great Lakes Carbon Corporation joined by respondents Standard Oil Company (Indiana), Conoco, Inc., Derby Refining Company, Farmland Industries, Inc., Sun Refining and Marketing Company, Texaco, Inc., and Mobil Oil Corporation (by its separate submission filed on January 7, 1985), request that the Commission reopen the proceeding in Docket No. 8805 and modify Paragraph X of the order to provide that the order terminate immediately. Upon consideration of Great Lakes' petition and other relevant information, the Commission now finds that the public interest warrants reopening the proceeding and modifying Paragraph X of the order as requested.

The record describes an industry in which the respondents' use of long-term sales and purchase contracts by and between the respondents and others for industrial quality petroleum coke would not appear likely to have anticompetitive effects during the next eight years. Changes in the market indicate that the order is no longer necessary and the order has accomplished all it is likely to do. At the same time, the order now appears to be limiting respondents' ability to compete effectively for, among other things, participation in cogeneration and waste heat recovery projects, development of new markets, and export sales. As a result, we conclude that it is in the public interest to set aside this order.

Accordingly,

It is ordered, That this matter be and it hereby is reopened, and that

Paragraph X of the Commission's order issued on June 5, 1973, be modified as follows:

X.

This order shall terminate and cease to be effective immediately upon entry of this order reopening and modifying the order issued on June 5, 1973.

In the Matter of

THE KORMAN CORPORATION

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-3155. Complaint, June 12, 1985—Decision, June 12, 1985

This consent order requires a Trevose, Pa. homebuilder, developer and real estate manager, among other things, to cease representing that it will correct any problems due to faulty materials, workmanship or design, unless the firm corrects the problems within a reasonable time after being informed of the defect by the homeowner. The firm is also barred from failing to perform its warranty obligations within a reasonable period of time and remedy non-warranted problems that the company has represented that it will correct. Should a written warranty be offered in connection with the sale of a home, a notice has to be conspicuously displayed in sales offices advising that a free copy of the warranty is available upon request. All limitations on, disclaimers of, or exclusions from coverage under the written warranty would have to be clearly and conspicuously disclosed within both the warranty and each sales contract used by the firm. If homes are covered by a written warranty, the firm has to use a prescribed dispute settlement process to resolve warranty disputes, and provide a written description of that process to each home purchaser. The order additionally requires the company to provide repairs or reimbursements, in accordance with redress procedures set forth in the order, to eligible homeowners who bought their homes since Oct. 1, 1978 and still own those homes; and to maintain specified files for a period of three years.

Appearances

For the Commission: *James K. Leonard.*

For the respondent: *Steven A. Arbittier* and *Roberta D. Liebenberg, Wolf, Block, Schorr & Solis-Cohen,* Philadelphia, Pa.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by such Act, the Federal Trade Commission, having reason to believe that The Korman Corporation, a corporation, hereinafter sometimes referred to as respondent, has violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Respondent The Korman Corporation is a corporation organized, existing and doing business under and by virtue of the laws of the State of Pennsylvania with its principal place of business located at 2 Neshaminy Interplex, Trevose, PA.

Respondent is now, and for some time past has been engaged, in the development of real estate; the construction of homes; the management of commercial and residential buildings; and the offering for sale and/or sale of these products and services to the public in the states of Pennsylvania and New Jersey. Gross revenues of respondent in 1981 were approximately $40 million.

PAR. 2. In the course and conduct of its business, respondent has caused its property, goods and services to be offered for sale and sold in New Jersey, Pennsylvania and other states to purchasers and prospective purchasers located in New Jersey, Pennsylvania and other States of the United States by means of advertisements placed in newspapers of interstate commerce.

Respondent maintains and has maintained a substantial business, including the acts and practices as hereinafter set forth, which are in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended.

COUNT I

Alleging violation of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One and Two are incorporated by reference.

PAR. 3. In the course and conduct of its business, respondent has been, directly or by implication, granting or disseminating certain warranties to purchasers of its homes.

1. Respondent has since 1976 provided purchasers with a written warranty under which it will repair, replace, or reimburse for:

a. Specific defects in the home's masonry, landscaping, driveways and walkways, water infiltration in the basement and crawl spaces, and excessive warping of structural members, doors, counter tops and vanities for a period of one year;

b. Specific defects in the roof and in any workmanship or prime materials in the electrical, heating, cooling and plumbing systems for a period of two years; and

c. Major construction defects, as defined in respondent's warranty, for a period of ten years.

2. Respondent has since 1972, by force of Pennsylvania common law, warranted that its new homes in Pennsylvania are fit for habitation.

3. Respondent has since 1979, by force of New Jersey statutory law, warranted that its new homes in New Jersey are:

a. Free from defects caused by faulty workmanship and defective materials for one year after purchase;

b. Free from defects caused by faulty installation of plumbing, electrical, heating and cooling delivery systems for two years after purchase; and

c. Free from major construction defects for ten years after purchase.

PAR. 4. By and through the granting and dissemination of the warranties described in Paragraph Three, respondent has represented, directly or by implication, that:

1. Respondent will correct all defects covered by its written warranty within a reasonable time after it receives notice of the defects.

2. Respondent will correct all defects covered by the warranties under Pennsylvania State law within a reasonable time after it receives notice of the defects.

3. Respondent will correct all defects covered by the warranties under New Jersey State law within a reasonable time after it receives notice of the defects.

PAR. 5. In truth and in fact, respondent has not performed its obligations under the warranties described in Paragraph Three.

1. Respondent has frequently failed to correct defects covered by the warranties described in Paragraph Three. Typical and illustrative of the uncorrected defects are:

a. Excessive ponding and severe washouts in yards due to insufficient and/or improper grading for water drainage;

b. Basement water leakage due to improper grading, failure to install foundation drainage tile, failure to properly patch foundation form tie holes, and/or failure to provide drainage in areaways adjacent to basement windows and doors;

c. Basement foundation cracks due to poor ground preparation and/or excessively wet concrete;

d. Roof leaks due to faulty workmanship, lack of flashing and counter flashing materials at roof intersections, and/or improper installation of roofing felts, plywood roof sheathing or shingles;

e. Roof depressions due to undersized and/or improperly installed roof rafters;

f. Bellied or buckled walls due to undersized or overspaced wall studs, resulting in inadequate support for the floor construction plus the roof load;

g. Inadequate heating due to undersized heating plants and/or a lack of, or improperly located, heating vents or return registers;

h. Frozen water pipes due to a lack of insulation and/or the improper placement of insulation in exterior walls;

i. Cracked concrete driveways and garage floor slabs and cracked and pitted asphalt driveways due to improper ground preparation and/or a lack of correctly located expansion and control joints; and

j. Spalling and pitting of sidewalks and flat concrete surfaces due to improper ground preparation and/or the use of unclean materials.

2. Where respondent has corrected defects covered by the warranties described in Paragraph Three, purchasers have frequently encountered long delays, often exceeding five months, from the time respondent received notice of the defect to the time respondent corrected the defect.

PAR. 6. Respondent's failure to perform its obligations under the warranties described in Paragraph Three has caused and causes substantial injury to consumers which they could not have reasonably avoided.

PAR. 7. Therefore, the statements, representations, acts and practices alleged in Paragraphs Three, Four and Five were and are unfair, in violation of Section 5 of the Federal Trade Commission Act.

COUNT II

Alleging violation of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One through Five are incorporated by reference.

PAR. 8. The statements, representations, acts and practices alleged in Paragraphs Three and Four, directly or by implication, have had, and now have, the capacity and tendency to mislead the public and were, and now are, to the prejudice and injury of the public.

PAR. 9. Respondent continued to grant or disseminate the warranties described in Paragraph Three to purchasers of its homes even though respondent knew or should have known of its failure to perform warranty obligations with respect to past purchasers' homes.

PAR. 10. Therefore, the statements, representations, acts and practices alleged in Paragraphs Three and Four were and are deceptive, in violation of Section 5 of the Federal Trade Commission Act.

COUNT III

Alleging violation of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One, Two and Three (1.) are incorporated by reference.

PAR. 11. In its written warranty respondent has further warranted that it will correct the following defects if notified by means of a registered letter within three days ("three-day letter") after settlement:

1. Significant defects in the appearance of interior and exterior finished surfaces, or in lighting fixtures.
2. Chipping of porcelain, tile, vitreous china, laminated plastic, counter and vanity tops.
3. Broken glass, light covers and mirrors.
4. Loose screws, nuts and bolts.
5. Missing items.

PAR. 12. By and through the granting and dissemination of its written warranty, respondent has represented that it will correct the defects listed in Paragraph Eleven within a reasonable time after it receives notice of the defects in a three-day letter.

PAR. 13. In truth and in fact, respondent has not performed its obligations with respect to items listed by purchasers in their three-day letters.

1. Respondent has frequently failed to correct listed defects.
2. Respondent has frequently failed to furnish missing items listed.
3. Respondent has frequently failed to replace defective items listed.
4. Where respondent has corrected, furnished, or replaced items listed, purchasers have frequently encountered long delays, often exceeding five months, from the time respondent received the three-day letter to the time respondent corrected the item.

PAR. 14. Respondent's failure to perform its obligations under the three-day letter has caused and causes substantial injury to consumers which they could not have reasonably avoided.

PAR. 15. Therefore, the statements, representations, acts and practices alleged in Paragraphs Eleven, Twelve and Thirteen were and are unfair, in violation of Section 5 of the Federal Trade Commission Act.

COUNT IV

Alleging violation of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One, Two, Three (1.), Eleven, Twelve and Thirteen are incorporated by reference.

PAR. 16. The statements, representations, acts and practices alleged in Paragraphs Eleven and Twelve, directly or by implication, have had, and now have, the capacity and tendency to mislead the public and were, and now are, to the prejudice and injury of the public.

PAR. 17. Respondent continued to grant or disseminate the written warranty described in Paragraphs Three (1.) and Eleven to purchasers of its homes even though respondent knew or should have known of its failure to perform its obligations with respect to items listed by past purchasers in their three-day letters.

PAR. 18. Therefore, the statements, representations, acts and practices alleged in Paragraphs Eleven and Twelve were and are deceptive, in violation of Section 5 of the Federal Trade Commission Act.

COUNT V

Alleging violation of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One and Two are incorporated by reference.

PAR. 19. In the course and conduct of its business, respondent has provided purchasers with an opportunity to inspect its homes approximately three days before and approximately thirty days after settlement while accompanied by respondent's representative and to have all readily apparent defects or incomplete items listed on a "Pre-/Post-Settlement Inspection Report" or other inspection report provided by respondent.

PAR. 20. Respondent has represented, directly or by implication, that it will correct or complete all listed items within a reasonable time after the post-settlement inspection.

PAR. 21. In truth and in fact, respondent has not performed its obligations with respect to listed items.

1. Respondent has frequently failed to correct defects listed. Typical and illustrative of the uncorrected defects are the following: uneven or bulging floors; buckling or poorly installed carpeting; severely cracked drywall surfaces; damages or defective shingles or siding; and improperly installed or poorly fitted windows and doors.
2. Respondent has frequently failed to complete all incomplete items listed. Typical and illustrative of the incomplete items are the following: missing insulation; missing doors, screens and storm windows; unfinished driveways; missing tile or fixtures; and missing gutters, downspouts or splash blocks.
3. Where respondent has corrected or completed listed items, purchasers have frequently encountered long delays, often exceeding five months, from the time of the post-settlement inspection to the time respondent corrected or completed the item.

PAR. 22. Respondent's failure to perform its obligations with respect to items listed on the Pre-/Post-Settlement Inspection Report or other inspection report has caused and causes substantial injury to consumers which they could not have reasonably avoided.

PAR. 23. Therefore, the statements, representations, acts and practices alleged in Paragraphs Nineteen, Twenty and Twenty-One were and are unfair, in violation of Section 5 of the Federal Trade Commission Act.

COUNT VI

Alleging violation of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One, Two, Nineteen, Twenty and Twenty-One are incorporated by reference.

PAR. 24. The statements, representations, acts and practices alleged in Paragraphs Nineteen and Twenty, directly or by implication, have had, and now have, the capacity and tendency to mislead the public and were, and now are, to the prejudice and injury of the public.

PAR. 25. Respondent continued to use the inspection procedure described in Paragraph Nineteen even though respondent knew or should have known of its failure to perform its obligations to past purchasers with respect to items listed on the Pre-/Post-Settlement Inspection Report or other inspection report.

PAR. 26. Therefore, the statements, representations, acts and practices alleged in Paragraphs Nineteen and Twenty were and are deceptive, in violation of Section 5 of the Federal Trade Commission Act.

The acts and practices of respondent alleged in Counts I through VI are continuing and will continue in the absence of the relief herein requested.

DECISION AND ORDER

The Federal Trade Commission having initiated an investigation of certain acts and practices of respondent The Korman Corporation, and respondent having been furnished thereafter with a copy of a draft of complaint which the Chicago Regional Office proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondent with violation of the Federal Trade Commission Act; and

Respondent, its attorney, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that respondent has violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent The Korman Corporation is a corporation organized, existing and doing business under and by virtue of the laws of the State of Pennsylvania, with its office and principal place of business located at 2 Neshaminy Interplex, in the City of Trevose, State of Pennsylvania.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of respondent, and the proceeding is in the public interest.

ORDER

For purposes of this order and all appendices attached hereto, the following definitions shall apply:

1. *Korman* shall mean respondent The Korman Corporation and its successors and assigns.

2. *Home* shall mean a new single-family residential unit in the United States which is a detached structure or an attached or semi-attached townhouse or twin unit and which is offered for sale or is sold to the general public by Korman.

3. A *specific problem* shall mean any single problem or any set of problems resulting from the same cause and involving the same component(s) or defect(s). For example, two or more leaking windows caused by improper installation shall be deemed a *specific problem.*

I.

It is ordered, That respondent The Korman Corporation, its successors and assigns, and its officers, agents, representatives and employees, directly or through any corporation, subsidiary, division or other device, in connection with the construction, advertising, offering for sale, or sale of any home in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, do forthwith cease and desist from:

A. Representing, directly or by implication, that Korman will correct or otherwise remedy any problem due to faulty materials, workmanship or design unless Korman does, in fact, correct or otherwise remedy such problem within a reasonable time after the homeowner has notified Korman of the problem; *provided, however,* that Korman may specify the method(s) that a homeowner must use to so notify Korman.

B. Failing to perform any warranty obligation, including correction of any problem inadequately repaired by Korman, within a reasonable time after the homeowner has made a request for warranty work; *provided, however,* that Korman may specify in its warranty the method(s) that a homeowner must use to make such a request, and *provided further,* that nothing herein shall preclude Korman from denying or contesting in good faith a warranty claim reasonably believed to be without merit, or in such cases from invoking any rights provided by law.

C. Failing, when Korman represents, directly or by implication, that it will correct or otherwise remedy any problem not covered by a warranty, to correct or otherwise remedy such problem within a reasonable time after the homeowner has notified Korman of the problem; *provided, however,* that Korman may specify the method(s) that a homeowner must use to so notify Korman.

II.

It is further ordered, That, in connection with any offering for sale of a home for which Korman provides a written warranty, Korman shall:

A. Clearly and conspicuously display in each sales office a notice that a copy of the warranty may be obtained free of charge upon request.

B. Provide a copy of the warranty to each prospective purchaser upon request.

C. Provide a copy of the warranty to each purchaser before or at the time of execution of the sales contract for the home.

D. Disclose clearly and conspicuously within the warranty and within each sales contract used by Korman any limitations on, disclaimers of, or exclusions from coverage under the written warranty or under any warranty under state law; *provided, however,* that Korman shall not make any representation, written or oral, concerning any such limitation, disclaimer or exclusion where such limitation, disclaimer or exclusion is prohibited by state or federal law.

III.

It is further ordered, That, in connection with any sale after the date of service of this Order of a home for which Korman provides a written warranty, Korman shall use a dispute settlement process conforming to Appendix A of this order to handle disputes concerning Korman's performance under the warranty and shall provide each purchaser with a written description of such dispute settlement process before or at the time of execution of the sales contract for the home; *provided, however,* that nothing herein shall prohibit Korman from using a form of sales contract which clearly and conspicuously provides that the homeowner agrees to resort to such dispute settlement process before pursuing any other remedy provided by law.

IV.

It is further ordered, That if after the date of service of this order Korman denies a request for warranty work Korman shall, within forty-five (45) days after receipt of the request, provide the homeowner with a detailed written statement of reasons for the denial, together with notice of the homeowner's right to submit any warranty dispute to a dispute settlement process conforming to Appendix A of this order and with notice that at the homeowner's request Korman will send the homeowner a written description of such process and the form(s) needed to initiate such process; *provided, however,* that Korman shall not be deemed to have denied a request for warranty work if it informs a homeowner who has made an oral complaint that a complaint must be made in writing.

V.

It is further ordered, That, for each homeowner who purchased a home from Korman from October 1, 1978, to the date of service of this order and who is still an owner of that home as of the date of service of this order, Korman shall establish and abide by redress procedures conforming to Appendix B of this order for any claim relating to the pre- or post-settlement inspection of such homeowner's home or made by such homeowner under Korman's written warranty, *provided,* that:

A. In the case of a claim relating to a pre- or post-settlement inspection, the problem had been listed on the Pre-/Post-Settlement Inspection Report or other inspection report at the time of the pre- or post-settlement inspection; or in the case of a warranty claim, the homeowner made the claim to Korman within the time period required by the warranty and there is credible written evidence in Korman's or the homeowner's possession to establish that the claim was then made; *provided, however,* that a record of a telephone message in Korman's possession shall not by itself establish that the claim was then made;

B. The claim has not been satisfied, and the value of the unsatisfied claim relating to a specific problem is established by credible written evidence to be $500 or more, measured:

1. For repairs already made, by the homeowner's out-of-pocket expenses to make the repairs or have them made; and
2. For repairs not yet made, by the estimated cost of repair by a contractor; and

C. In the case where the homeowner has modified the home in a manner that substantially increases the cost of repairing or otherwise correcting a problem, Korman shall not be required to bear the increase in cost of repair or correction resulting from the modification.

VI.

It is further ordered, That Korman shall maintain the following records and shall make such records available to the Commission for inspection and copying upon reasonable notice:

A. For three years after the date of service of this order, all documents related to requests for redress under Part V of this order, including action taken in response thereto; and

B. For three years after the sale of any home, all documents relating to any such home and to:

1. Korman's issuance of a written warranty to any purchaser;
2. Any request for warranty work, including action taken in response thereto; and
3. Any dispute handled under the dispute settlement process required by Part III of this order.

VII.

It is further ordered, That Korman shall notify the Commission at least thirty (30) days before any proposed change in Korman's corporate status, such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporation which may affect compliance obligations arising out of this order.

VIII.

It is further ordered, That Korman shall, within thirty (30) days of the date of service of this order, distribute a copy of this order to (a) each of Korman's operating subsidiaries and divisions, and (b) each officer and supervisory employee of Korman and of said subsidiaries and divisions who is engaged in the construction, advertising, offering for sale, or sale of any home or in customer service related to any home sold by Korman.

IX.

It is further ordered, That within ninety (90) days after the date of service of this order, and again within ninety (90) days after the completion of Korman's obligations under Part V of this order or within two years after the date of service of this order, whichever comes first, Korman shall file with the Commission a report, in writing, setting forth in detail the manner in which it has complied with this order.

X.

It is further ordered, That all provisions of this order except Part I shall expire ten (10) years after the date of service of this order.

APPENDIX A

Dispute Settlement Process

The dispute settlement process required by this order shall include the following:

1. The process shall be organized and staffed to ensure the fair and timely disposition of all disputes.

2. The process shall be available to homeowners for a filing fee of up to $75 during the three years after the date of service of this order, a fee of up to $100 during the fourth through sixth years after the date of service of this order, and a fee of up to $125 thereafter. One filing fee shall cover multiple disputes that are filed simultaneously. The filing fee shall be refunded if each dispute filed under the fee is settled before a hearing is held under Paragraph 6 below.

3. After a homeowner files a dispute, written acknowledgement of the filing shall be sent to the homeowner.

4. The process shall use an independent Dispute Settler who is knowledgeable about home construction.

5. The Dispute Settler shall:

(a) Be bound by the provisions of Korman's written warranty and any express or implied warranties arising from state law and

(b) Use a consistent set of standards, such as the Home Owners Warranty Program

Quality Standards, relevant provisions of the building code in the jurisdiction in which the home is located, and other relevant information to interpret the warranty provisions.

6. Unless otherwise agreed to by the homeowner and Korman, the Dispute Settler shall hold a hearing and render a decision in writing within sixty (60) days after the dispute is filed or, if Korman is a participant in an informal dispute settlement procedure for which the Commission has granted an exemption to the 40-day requirement in 16 C.F.R. 703.5(d), within the time period established by such exemption, whichever is longer. The decision shall determine:

(a) What corrective action, if any, Korman shall take in response to the homeowner's warranty claim(s); and

(b) The time allowed after Korman receives the homeowner's acceptance of a decision for Korman to perform such corrective action or otherwise settle the dispute.

A copy of the decision shall be mailed to the homeowner within one week after the Dispute Settler renders the decision. If the homeowner is required by the sales contract to resort to this dispute settlement procedure before pursuing any other remedy provided by law, he/she will be deemed to have fulfilled that requirement if a decision is not rendered within the required time period.

7. The Dispute Settler's decision shall be binding on both Korman and the homeowner if the homeowner accepts the decision. If the homeowner rejects the decision, he/she shall have the right to pursue any other legal remedies available. At the time the homeowner receives a copy of the decision, he/she shall be provided with a form enabling him/her to accept the decision, along with notice that if the homeowner does not accept the decision by signing and returning it to Korman within forty-five (45) days of receiving a copy of the decision and the aforesaid form, the homeowner shall be deemed to have rejected the decision, and Korman shall be under no obligation to comply with the decision.

8. If the homeowner accepts the decision, Korman shall comply with the decision.

APPENDIX B

Redress Procedures

The redress procedures required by this order shall include the following:

1. Within sixty (60) days after the date of service of this order, Korman shall send by postage-paid first-class mail addressed to the original owner(s) of any home sold by Korman from October 1, 1978, to the date of service of this order a letter identical in content to that in Appendix C together with a copy of the written warranty for such home and claim forms identical in content to those in Appendix D; *provided, however*, that Korman is not required to make such a mailing to any home which Korman knows is no longer owned, in whole or in part, by any person who purchased the home from Korman.

2. Within sixty (60) days after the date of the mailing required by Paragraph 1, the homeowner shall mail or deliver a claim to Korman or forfeit any right to repairs or reimbursement under this order.

3. Within sixty (60) days after receipt of any claim for redress, Korman shall provide the homeowner with a written description of the dispute settlement process required by Paragraph 5 of this Appendix and with the form(s) needed to initiate such process and shall respond in writing to the homeowner by either:

(a) Offering to settle the claim within a stated time by performing specified remedial measures and/or paying an amount of money, and at the same time informing the homeowner of his/her right to accept or reject the offer, along with notice that:

(i) If the homeowner accepts the offer, he/she has the right to submit any dispute over Korman's performance under the offer to the dispute settlement process; and

(ii) If the homeowner rejects the offer, he/she has the right to submit the disputed claim to the dispute settlement process; or

(b) Denying the claim and at the same time giving the homeowner a detailed written statement of reasons for the denial, along with notice that the homeowner has the right to submit the denied claim to the dispute settlement process.

4. If the homeowner accepts the offered remedy, Korman shall perform the remedy within the time promised.

5. The dispute settlement process shall include the following:

(a) The process shall be organized and staffed to ensure the fair and timely disposition of all disputes.

(b) The process shall be available to homeowners for a filing fee of up to $75. One filing fee shall cover multiple disputes that are filed simultaneously. The filing fee shall be refunded if a decision rendered under subparagraph (f) below includes an award of reimbursement of the filing fee.

(c) After a homeowner files a dispute, written acknowledgement of the filing shall be sent to the homeowner.

(d) The process shall use an independent Dispute Settler who is knowledgeable about home construction.

(e) To decide warranty claims and to decide claims relating to a pre- or post-settlement inspection, the Dispute Settler shall:

(i) Be bound by the provisions of Korman's written warranty, the relevant pre- or post-settlement inspection report, and any express or implied warranties arising from state law and

(ii) Use a consistent set of standards, such as the Home Owners Warranty Program Quality Standards, relevant provisions of the building code in the jurisdiction in which the home is located, and other relevant information to interpret the warranty provisions and the pre- or post-settlement inspection report.

(f) Unless otherwise agreed to by the homeowner and Korman, the Dispute Settler shall hold a hearing and render a decision in writing within sixty (60) days after the dispute is filed. The decision shall:

(i) Include reimbursement of the filing fee unless the arbitrator determines that each of the homeowner's claims was not substantially justified;

(ii) Determine what corrective action, if any, Korman shall take in response to the homeowner's warranty claim(s) or claim(s) relating to a pre- or post-settlement inspection; and

(iii) Determine the time allowed after Korman receives the homeowner's acceptance of a decision for Korman to perform such corrective action or otherwise settle the dispute.

A copy of the decision shall be mailed to the homeowner within one week after the Dispute Settler renders the decision.

(g) The Dispute Settler's decision shall be binding on both Korman and the homeowner if the homeowner accepts the decision. At the time the homeowner receives a copy of the decision, he/she shall be provided with a form enabling him/her to accept the decision, along with notice that:

(i) If the homeowner accepts the decision, both he/she and Korman shall be bound by the decision, and the homeowner shall have the right to submit any dispute over the actual performance of the decision to the dispute settlement process at no cost to the homeowner; *provided, however,* that the homeowner's submission of such dispute must be made within sixty (60) days after Korman's performance of the decision;

(ii) If the homeowner does not accept the decision, neither he/she nor Korman shall be bound by the decision, and the homeowner shall have the right to pursue any other legal remedies available; and

(iii) If the homeowner does not accept the decision by signing and returning it to Korman within forty-five (45) days of receiving a copy of the decision and the aforesaid form, the homeowner shall be deemed to have rejected the decision, and Korman shall be under no obligation to comply with the decision.

(h) If the homeowner accepts the decision, Korman shall comply with the decision.

APPENDIX C

Redress Letter

Dear Korman Homeowner:

This letter is to notify you that you may be entitled to have certain repairs made to your home at no cost to you. You may also qualify for reimbursement of money you have already spent repairing your home. Korman is doing this because of an agreement with the Federal Trade Commission and our desire to make you, the Korman homeowner, a comfortable and satisfied homeowner.

If you purchased your home from us on or after October 1, 1978, and if you were still the owner on (date of service of the order), you may be entitled to certain repairs or reimbursement for claims you made under Korman's written warranty or for items listed during the pre- or post- settlement inspection of your home. A copy of the warranty is enclosed.

For a warranty claim to be eligible for repairs or reimbursement, it must be a claim covered by the warranty and there must be credible written evidence that you made the claim within the time period required by the warranty. A claim related to a pre- or post-settlement inspection must be for a problem that was listed on your inspection report.

A claim is eligible for repair or reimbursement only if the claim relates to a specific problem and the value of the claim is $500 or more. A "specific problem" is any single problem or a set of problems resulting from the same cause and involving the same component(s) or defect(s). For example, two or more leaking windows caused by improper installation would be a "specific problem." To determine whether a claim meets the $500 requirement, you can measure the value of the claim like this:

For repairs which have already been done, the value of a claim is measured by your out-of-pocket expenses to make the repairs or have them made. You must have written evidence (cancelled checks, receipts, etc.) of your out-of-pocket expenses and must submit this evidence with your claim.

For repairs which have not yet been done, the value of a claim is measured by the estimated cost of repair by a contractor. The contractor's estimate must be in writing and must be detailed enough to show how the estimate was calculated. You must submit the estimate with your claim.

Please note that if you have modified the part of your home affected by a problem, and if you made the modification in a manner that substantially increases the cost of repairing the problem, we will not bear the increase in repair cost resulting from the modification. For example, if you finished your basement and thus covered up a problem, we are not responsible for the cost of refinishing your basement after our repair work.

The eligibility requirements for warranty claims and for claims related to your pre- or post-settlement inspection are summarized below.

Warranty Claims

You are eligible for repairs or reimbursement under the warranty if all of the following are true:

1. You experienced a problem that was covered by the warranty. See the enclosed warranty for a description of covered problems.
2. You or Korman has credible written evidence that you made a claim concerning the problem within the time period required by the warranty. If you do not have a copy of a letter or some other record showing that you made a claim, we will check our customer files for any record of your complaint about the problem. If our files contain, for example, a letter from you or a Korman work order authorizing repair of the problem, this would show that you made a warranty claim. But a phone message in our files will not by itself establish that you made a claim.
3. The value of a claim related to a specific problem is $500 or more.
4. Korman did not repair the problem or inadequately repaired the problem. Repair is considered to be inadequate if it failed to meet industry standards.

Claims Related to the Pre- or Post-Settlement Inspection

You are eligible for repairs or reimbursement for this type of claim if all of the following are true:

1. The problem was listed on your "Pre-/Post-Inspection Report" or other inspection report. If you do not have a copy of your inspection report, we will check our files for it.
2. The value of a claim related to a specific problem is $500 or more.
3. Korman did not repair the problem or inadequately repaired the problem. Repair is considered to be inadequate if it failed to meet industry standards.

WHAT YOU MUST DO

If you think you are eligible for repairs or reimbursement, please fill out the enclosed "Claim Form" and mail it in the enclosed pre-addressed envelope to:

(Name)
The Korman Corporation
2 Neshaminy Interplex
Trevose, PA 19407

You must mail or deliver this claim form to us by (60 days from the mailing date of this *letter). If you miss this deadline, you will not be eligible for repairs or reimbursement.* Remember to keep a copy of your claim and a record of the date you mail it, just in case your claim gets lost in the mail.

Korman will review your claim(s) in accordance with industry standards for homebuilders. Within 60 days of receiving your letter we will tell you whether we will honor your claim. If we dispute any part of your claim, we will tell you why. If you are not satisfied with what we offer you as a repair or reimbursement, you will have the right to take the dispute to an impartial arbitrator. We will explain the details of the arbitration program when we reply to your claim.

If you have any questions about this repair and reimbursement program, call (name of Korman representative) at (phone number) between the hours of 9:00 a.m. and 5:00 p.m., Monday through Friday.

Very truly yours,

The Korman Corporation

Enclosures: Copy of your warranty
Claim forms
Self-addressed envelope

APPENDIX D

Claim Form

This claim form must be mailed or delivered to us by (60 days from the mailing date of the letter of notification). If you miss this deadline, you will not be eligible for repairs or reimbursement.

Today's date __________________

I. HOMEOWNER INFORMATION

Name(s) of Homeowner(s) ______________________________

Telephone (Home) ______________________________

(Work) ______________________________

Mailing Address ______________________________
(Street)

____
(City) (State) (Zip Code)

II. ADDRESS OF KORMAN HOME

The address of my (our) Korman home is:

____
(Street)

____
(City) (State) (Zip Code)

____
(Name of Subdivision)

III. ELIGIBILITY TO SUBMIT A CLAIM

A. I (we) bought my (our) home:

MARK ONE ( ) From Korman

( ) From another party

NOTE: To be eligible for repairs or reimbursement, you must have bought *directly* from Korman.

B. The date of settlement/closing on my (our) Korman home was:

____

(Enter date you took title)

NOTE: To be eligible for repairs or reimbursement, you must have bought your home *on or after October 1, 1978.*

C. On (date of service of the Order):

MARK ONE ( ) I was (we were) the owner of this Korman home.

( ) I was (we were) no longer the owner of the Korman home.

NOTE: To be eligible for repairs or reimbursement, you must have been the owner as of (date of service of the Order).

IV. WARRANTY CLAIMS

Instructions

- List each problem separately, using additional sheets of paper if necessary.
- Remember that each problem must have a value of $500 or more.
- Describe in detail the nature of each problem.
- Attach a copy (*not* originals) of any written evidence you have that shows you made a claim concerning the problem within the time period required by the warranty. This can be a copy of a letter or any other record showing that you notified us about the problem. If you do not have written evidence that you made a warranty claim about a problem, we will check our customer files to see if we have any record showing that you made a claim within the warranty time period. A telephone message in our files will not by itself establish that you made a timely warranty claim. *If there is no other written evidence in either our possession or yours that you made a timely claim, we can deny your claim for a problem.*
- If you are requesting repair of a problem, describe the repair below and attach a copy (*not* the original) of a contractor's estimate of the cost of repair. The contractor's estimate must be detailed enough to show how the estimate was calculated.
- If you are requesting reimbursement of money you spent for repairs, describe the repairs and your expenses below and attach a copy (*not* originals) of cancelled checks or receipts showing that you paid for repairs. Also attach a copy (*not* originals) of any other document(s) showing what repairs were made and what you paid for them.

Claim(s) for repairs or reimbursement under the warranty

I (we) request The Korman Corporation to make repairs or reimbursement under the warranty for the following problem(s):

[Describe the repairs which you request and/or the repairs and expenses for which you request reimbursement]

V. CLAIMS RELATED TO THE PRE-SETTLEMENT OR POST-SETTLEMENT INSPECTION

Instructions

- List each problem separately, using additional sheets of paper if necessary.
- Remember that each problem must have a value of $500 or more.
- Describe in detail the nature of each problem.
- Attach a copy (*not* originals) of your "Pre-/Post-Settlement Inspection Report" or other inspection report. If you do not have your inspection report, we will look for it in our files. If a problem was not listed on the inspection report, it is *not* eligible for repair or reimbursement.
- If you are requesting repair of a problem, describe the repair below and attach a copy (*not* the original) of a contractor's estimate of the cost of repair. The contractor's estimate must be detailed enough to show how the estimate was calculated.
- If you are requesting reimbursement of money you spent for repairs, describe the repairs and your expenses below and attach a copy (*not* originals) of cancelled checks or receipts showing that you paid for repairs. Also attach a copy (*not* originals) of any other document(s) showing what repairs were made and what you paid for them.

Claim(s) for repairs or reimbursement under the pre- or post-settlement inspection

I (we) request The Korman Corporation to make repairs or reimbursement for the following problem(s) related to the pre- or post-settlement inspection:

[Describe the repairs which you request and/or the repairs and expenses for which you request reimbursement]

IN THE MATTER OF

CRAFTMATIC/CONTOUR ORGANIZATION, INC., ET AL.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF THE FEDERAL TRADE COMMISSION ACT AND THE MAGNUSON-MOSS WARRANTY—FEDERAL TRADE COMMISSION IMPROVEMENT ACT

Docket C-3156. Complaint, June 13, 1985—Decision, June 13, 1985

This consent order requires two Trevose, Pa. sellers of electric adjustable beds and their individual owner, among other things, to cease denying responsibility of their written warranties; failing to fully and promptly honor valid warranty claims; and failing to disclose relevant information concerning any other guarantor. The firms are required to clearly and prominently disclose in advertisements and promotional materials offering any product warranty, either the nature and extent of all material limitations and exclusions of the warranty (including any requirement that consumers seeking to obtain warranty performance are obliged to arrange for shipping and/or pay shipping charges) or a statement advising that the warranty contains major limitations and exclusions and should be consulted by the prospective buyer prior to purchase. The order also bars the companies from disseminating to their door-to-door sellers written promotional materials that do not contain copies of all written warranties offered and disclose to prospective buyers that the sales representative has copies of such warranties available for the consumer's inspection. The companies are further required to comply fully with the Pre-Sale Availability Rule; maintain specified records concerning warranty performance for a period of four years; and provide their current distributors and retailers with a copy of the order and the attached notice.

Appearances

For the Commission: *Rachel Miller.*

For the respondents: *Charles B. Chernofsky,* New York City.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, as amended, and of the Magnuson-Moss Warranty—Federal Trade Commission Improvement Act ("Warranty Act") and the implementing Rules promulgated under the Warranty Act, and by virtue of the authority vested in it by said Acts, the Federal Trade Commission, having reason to believe that Craftmatic/Contour Organization, Inc., and Craftmatic Comfort Mfg. Corp., corporations, and Stanley Kraftsow, individually and as an officer and director of said corporations, ("respondents") have violated the provisions of those Acts and implementing Rules, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

I

PARAGRAPH 1. Respondent Craftmatic/Contour Organization, Inc., ("Craftmatic/Contour") is a corporation organized, existing and doing business under and by virtue of the laws of the Commonwealth of Pennsylvania. Respondent Craftmatic/Contour is wholly-owned by below-named respondent Stanley Kraftsow. Respondent Craftmatic/Contour was formerly named Craftmatic Wholesale, Inc., ("CWI"), and was a wholly-owned subsidiary of Kraftsow Organization, Inc., ("KOI"), a Delaware corporation, which in turn was wholly-owned by respondent Stanley Kraftsow. On or about April 1, 1984, CWI was merged with KOI and with Contour Inc. of Pa. ("Contour"), a former Pennsylvania corporation and wholly-owned subsidiary of KOI. Prior to January 1, 1982, Contour was wholly-owned by respondent Stanley Kraftsow.

Respondent Craftmatic Comfort Mfg. Corp. ("CCM") is a corporation organized and existing under and by virtue of the laws of the Commonwealth of Pennsylvania. Prior to January 1, 1982, respondent CCM was wholly-owned by respondent Stanley Kraftsow. From January 1, 1982 to April 1, 1984, respondent CCM was a wholly-owned subsidiary of KOI. Since April 1, 1984, respondent CCM has been a wholly-owned subsidiary of Contour Chair-Lounge Co., Inc., a Missouri corporation whose common stock is wholly-owned by respondent Stanley Kraftsow.

The principal office and place of business of the two corporate respondents is 2500 Interplex Drive, Trevose, PA.

Respondent Stanley Kraftsow ("Kraftsow") is an individual and is, and for some time past has been, the principal officer and director of respondents Craftmatic/Contour and CCM. Respondent Kraftsow was also the principal officer and director of Contour and KOI during their existence. Respondent Kraftsow also is and has been the sole shareholder of respondent Craftmatic/Contour and of Contour Chair-Lounge Co., Inc. Individually, or in concert with others, respondent Kraftsow has directed, controlled and formulated the business practices of respondents Craftmatic/Contour and CCM, and of Contour and KOI during their existence, including the acts and practices alleged in this complaint. His business address is the same as that of the corporate respondents. His residential address is 120 Surrey Road, Melrose Park, PA.

PAR. 2. Respondents Craftmatic/Contour and Kraftsow are now, and for some time past have been, engaged in the business of distribution, advertising, offering for sale and sale of electric adjustable beds and other products to the public directly and through distributors and retailers.

Respondent CCM was also engaged in such business until about January 1, 1982.

Respondents have cooperated and acted together as a single business entity in carrying out the acts and practices set forth below.

PAR. 3. In the course and conduct of their business, respondents have distributed, advertised, offered for sale or sold, or caused to be distributed, advertised, offered for sale or sold, respondents' products in more than 25 states. Respondents therefore have engaged in a substantial course of trade in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended.

PAR. 4. In the course and conduct of their business, respondents have offered and advertised warranties identifying respondents as warrantor, both to consumers who purchase respondents' products from respondents or their representatives and to consumers who purchase respondents' products through distributors or retailers. Respondents' products are "consumer products," the warranties described herein are "written warranties" offered to "consumers" on "consumer products" distributed in "commerce," and respondents are "warrantors", as these terms are defined in the Warranty Act. Respondents' products are also "consumer products," the warranties described herein are "written warranties," and respondents are "warrantors," as defined in the Federal Trade Commission's Rule on Pre-Sale Availability of Written Warranty Terms ("Pre-Sale Availability Rule"), 16 C.F.R. 702, implementing Section 102(b)(i)(A) of the Warranty Act. Respondents have also offered for sale and sold their products for purposes other than resale or use in the ordinary course of the buyer's business, by means of personal solicitation by respondents or their sales representatives at the buyer's home. Respondents are therefore "sellers" of "consumer products" by means of "door-to-door sales," as these terms are defined in the Pre-Sale Availability Rule.

II

The allegations of Paragraphs One through Four above are incorporated by reference in this Part as though fully set forth below.

PAR. 5. By means of the offer and advertisement of said warranties, respondents have represented, directly or by implication, to consumers who purchase respondents' products through distributors, that respondents will fully and promptly honor the warranties extended to such consumers.

PAR. 6. However, respondents have failed and refused in numerous instances to honor, fully and promptly as represented, warranties issued to such consumers purchasing respondents' products through distributors.

PAR. 7. The acts and practices alleged in Paragraphs Four through Six above are misleading, deceptive and unfair.

PAR. 8. Further, respondents have expressly represented to consumers and to others that respondents have no obligation or legal liability under such warranties issued to consumers purchasing respondents' products through distributors.

PAR. 9. In truth and in fact, respondents are legally obligated to perform according to their warranties, under Section 107 of the Warranty Act and other laws. The representations alleged in Paragraph Eight above are therefore false, deceptive and misleading.

III

The allegations of Paragraphs One through Four above are incorporated by reference in this Part as though fully set forth below.

PAR. 10. Respondents have failed in numerous instances to make copies of their written warranties available, prior to sale, to prospective buyers of respondents' products from respondents or their sales representatives, as required by Section 702.3(d)(2) of the Pre-Sale Availability Rule.

PAR. 11. Respondents have failed in numerous instances to disclose, in their written materials that are shown to prospective buyers of respondents' products from respondents or their sales representatives, the availability of written warranties offered with respect to such products as required by Section 702.3(d)(2) of the Pre-Sale Availability Rule.

PAR. 12. Respondents have failed in numerous instances to provide to distributors of respondents' products copies of respondents' written warranties as needed for such distributors to comply with Section 702.3(d)(2) of the Pre-Sale Availability Rule. Such failure is in violation of Section 702.3(b)(1)(ii) of the Pre-Sale Availability Rule.

PAR. 13. Respondents' violations of the Pre-Sale Availability Rule as alleged in Paragraphs Ten through Twelve above violate the Warranty Act, and, by virtue of Section 110(b) of that Act, violate Section 5(a)(1) of the Federal Trade Commission Act as well.

IV

The allegations of Paragraphs One through Four are incorporated by reference in this Part as though fully set forth below.

PAR. 14. Respondents' warranties have contained provisions obligating consumers seeking warranty performance to return the defective product or component for repair or replacement. Typical and illustrative of such provisions is the following:

> If you believe that you have a claim under this Limited Warranty, you should . . . deliver back to the [selling] dealer the mattress or foundation. This Warranty does not include any responsibility for transportation of the said mattress or foundation, which will be the responsibility of the customer.

By means of such provisions, all costs and efforts of dismantling, packaging, shipping both directions and reassembly have been made the responsibility of the consumer. This obligation is a material term of respondents' warranties.

PAR. 15. Respondents have advertised certain of their warranties' terms in written materials provided or shown to prospective purchasers at or before sale. Typical and illustrative of such advertising is the following:

> COIL SPRING MATTRESS COMES WITH 15-YEAR LIMITED WARRANTY. If during the first year after original delivery there should be any factory defect in material or workmanship, Craftmatic will repair or replace it free of charge for parts and labor. Between the second and fifteenth year, we will replace your mattress with a new one, making a prorata charge for the months beyond the first twelve after it had been first delivered. So far as we know, this is the most liberal guarantee of any manufacturer in the country.

These materials fail to disclose the obligation described in Paragraph Fourteen above to return a defective item at the consumer's cost.

PAR. 16. By means of the materials described in Paragraph Fifteen above, respondents have represented directly or by implication that the stated terms are a true and complete statement of the material warranty benefits and obligations offered by respondents as to respondents' mattresses.

PAR. 17. In truth and in fact, the stated terms as described in Paragraph Fifteen above are not a true and complete statement of the material warranty benefits and obligations offered by respondents as to respondents' mattresses. Therefore the representation alleged in Paragraphs Fifteen and Sixteen above is false and deceptive.

PAR. 18. The acts and practices as alleged herein all have the capacity and tendency to mislead members of the purchasing public.

PAR. 19. The acts and practices as alleged herein are all to the prejudice and injury of the public and constitute unfair and deceptive acts or practices in or affecting commerce, in violation of Section 5(a) of the Federal Trade Commission Act. The acts and practices as alleged herein are continuing and will continue in the absence of the relief herein requested.

DECISION AND ORDER

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondents named in the caption hereof, and the respondents having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondents with violation of the Magnuson-Moss Warranty—Federal Trade Commission Improvement Act and the Federal Trade Commission Act; and

The respondents, their attorney, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondents of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondents that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondents have violated the said Acts, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, and having duly considered the comments filed thereafter by interested persons pursuant to Section 2.34 of its Rules, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Craftmatic/Contour Organization, Inc., ("Craftmatic/Contour") is a corporation organized, existing and doing business under and by virtue of the laws of the Commonwealth of Pennsylvania. Respondent Craftmatic/Contour is wholly-owned by below-named respondent Stanley Kraftsow. Respondent Craftmatic/Contour was formerly named Craftmatic Wholesale, Inc., ("CWI"), and was a wholly-owned subsidiary of Kraftsow Organization, Inc., ("KOI"), a Delaware corporation, which in turn was wholly-owned by respondent Stanley Kraftsow. On or about April 1, 1984, CWI was merged with KOI and with Contour Inc. of Pa. ("Contour"), a former Pennsylvania corporation and wholly-owned subsidiary of KOI. Prior to January 1, 1982, Contour was wholly-owned by respondent Stanley Kraftsow.

Respondent Craftmatic Comfort Mfg. Corp. ("CCM") is a corporation organized and existing under and by virtue of the laws of the Commonwealth of Pennsylvania. Prior to January 1, 1982, respondent CCM was wholly-owned by respondent Stanley Kraftsow. From January 1, 1982 to April 1, 1984, respondent CCM was a wholly-owned subsidiary of KOI. Since April 1, 1984, respondent CCM has been a wholly-owned subsidiary of Contour Chair-Lounge Co., Inc., a Missouri corporation whose common stock is wholly-owned by respondent Stanley Kraftsow.

The principal office and place of business of the two corporate respondents is 2500 Interplex Drive, Trevose, PA.

Respondent Stanley Kraftsow ("Kraftsow") is an individual and is, and for some time past has been, the principal officer and director of respondents Craftmatic/Contour and CCM. Respondent Kraftsow was also the principal officer and director of Contour and KOI during their existence. Respondent Kraftsow also is and has been the sole shareholder of respondent Craftmatic/Contour and of Contour Chair-Lounge Co., Inc. Individually, or in concert with others, respondent Kraftsow has directed, controlled and formulated the business practices of respondents Craftmatic/Contour and CCM, and of Contour and KOI during their existence, including the acts and practices alleged in this complaint. His business address is the same as that of the corporate respondents. His residential address is 120 Surrey Road, Melrose Park, PA.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

ORDER

The definition of *commerce* contained in Section 4 of the Federal Trade Commission Act, 15 U.S.C. 44, shall apply to this order.

The definitions of *written warranty, consumer,* and *consumer product* contained in Section 101 of the Magnuson-Moss Warranty Act ("Warranty Act"), 15 U.S.C. 2301, shall apply to this order except as noted below.

The definitions of *consumer product, written warranty, seller, door-to-door sale,* and *prospective buyer* contained in the Federal Trade Commission's Rule on Pre-Sale Availability of Written Warranty Terms ("Pre-Sale Availability Rule"), 16 C.F.R. 702, implementing Section 102(b)(1)(A) of the Warranty Act, shall apply to Part IV of this order.

I

It is ordered, That respondents Craftmatic/Contour Organization, Inc., and Craftmatic Comfort Mfg. Corp., corporations, and Stanley Kraftsow, individually and as an officer and director of said corporations, their successors and assigns, and their officers, agents, representatives, and employees, directly or through any corporation, subsidiary, division, or other device, in connection with the distribution, advertising, offering for sale or sale of any bed or other consumer product in or affecting commerce, do forthwith cease and desist from representing, directly or by implication, that any such product carries a written warranty, if that warranty is offered or issued by anyone other than a respondent, its successor or assign, without:

a. Disclosing, clearly and prominently with such representation, that the warranty is not offered or issued by any respondent, its successor or assign; and

b. Identifying, clearly and prominently with such representation, who does offer the warranty.

II

It is further ordered, That respondents, their successors and assigns, and their officers, agents, representatives, and employees, directly or through any corporation, subsidiary, division, or other device, in connection with the offering or issuance of any written warranty with respect to any consumer product distributed, advertised, offered for sale or sold in or affecting commerce, do forthwith cease and desist from:

a. Denying that respondents, their successors and assigns are responsible for performance of such written warranty; and

b. Failing to honor and satisfy, fully and within a reasonable time, every valid claim arising under such written warranty;

Provided, That, if any respondent, its successor or assign designates any representative to perform duties under a written warranty, that respondent or its successor or assign and that representative may allocate among themselves costs for warranty performance in any manner consistent with the requirements of Section 107 of the Warranty Act, 15 U.S.C. 2307, but such designation or allocation shall not relieve respondents, their successors and assigns, and their officers, agents, representatives, and employees of their direct obligation to honor and satisfy, fully and within a reasonable time, every valid claim arising under the written warranty, and

Provided further, That, if any such product is offered for sale or sold with a warranty that clearly and prominently identifies the selling dealer as the sole warrantor obligated to honor the warranty, and if the selling dealer for that product is not a respondent, its successor or assign, then this provision of the order shall not apply to that warranty on that product.

III

It is further ordered, That respondents, their successors and assigns, and their officers, agents, representatives and employees, within thirty (30) days after receiving notice of a request for such satisfaction, shall honor and satisfy fully every valid claim arising under any outstanding written or implied warranty offered or issued by any respondent, its successor or assign with respect to any adjustable bed or chair, or component or accessory thereof, in or affecting commerce, if that claim was originally lodged with any distributor, retailer or respondent, its successor or assign, orally or in writing, prior to the date of service of this order; and, upon concluding reasonably and in good faith that any person requesting such satisfaction for such a claim is not entitled to all or part of the relief requested under any applicable written or implied warranty, and upon choosing to deny the request in whole or in part based upon such conclusion, shall send to the requester a written notice explaining the denial and the reasons therefor (a signed statement from the requester, or from another person with such knowledge, that such claim was lodged prior to the date of service of this order, shall be sufficient evidence of such lodging for purposes of this order provision); *provided,* that, if any respondent, its successor or assign designates any representative to perform duties under any warranty, that respondent or its successor or assign and that representative may allocate among themselves costs for warranty performance in any manner consistent with the requirements of Section 107 of the Warranty Act, 15 U.S.C. 2307, but such designation or allocation shall not relieve respondents, their successors and assigns, and their officers, agents, representatives, and employees of their direct obligation to honor and satisfy claims and provide notice of denials as specified herein.

IV

It is further ordered, That respondents, their successors and assigns, and their officers, agents, representatives, and employees, directly or through any corporation, subsidiary, division, or other device, in connection with the distribution, advertising, offering for sale or sale of any consumer product in or affecting commerce, do forthwith cease and desist from:

a. Failing to give to every buyer of any such consumer product in a door-to-door sale, prior to or upon execution of the sale, a copy of every written warranty offered or issued with respect to that consumer ~~product, *provided*,~~ that, giving to a buyer a copy of a sales contract with such a written warranty printed clearly and legibly on the reverse side, and with a clear and prominent reference on the face to the warranty on the reverse side, shall satisfy this requirement as to that warranty for that buyer.

b. Disseminating to any door-to-door seller any written materials intended to be shown to any prospective buyer of any such consumer product in a door-to-door sale offer, that fail to contain:

i. Copies of every written warranty offered or issued with respect to that consumer product; and

ii. A clear and prominent disclosure that the sales representative has copies of such warranties, which may be inspected by the prospective buyer at any time during the sales presentation.

c. Failing to comply fully with the Pre-Sale Availability Rule, as amended from time to time.

V

It is further ordered, That respondents, their successors and assigns, and their officers, agents, representatives, and employees, directly or through any corporation, subsidiary, division, or other device, in connection with the preparation, approval or dissemination of any advertising or promotional material that is mailed, shipped or shown to any consumer and that describes any written warranty offered or issued with respect to any consumer product distributed, advertised, offered for sale or sold in or affecting commerce, do forthwith cease and desist from failing to disclose, clearly and prominently, either:

a. The nature and extent of all material limitations and exclusions of the warranty, including any requirement that consumers arrange or pay any charge for shipping, or pay a servicer or truck travel or similar charge, in order to obtain performance under the warranty; or

b. The following:

i. That there are other major limitations and exclusions of the warranty and that customers should consult the warranty before making a purchase; and

ii. Where any such material describes the warranty as free of charge for parts and labor and the warranty requires any consumer to arrange or pay any charge for shipping, or to pay a servicer or truck travel or similar charge, in order to obtain performance under the warranty: the fact that there may be costs for shipping or such other requirement.

VI

It is further ordered, That respondents, their successors and assigns, and their officers, agents, representatives, and employees, directly or through any corporation, subsidiary, division, or other device, do forthwith cease and desist from requiring any consumer who purchased any adjustable bed, bed component, or bed accessory prior to the date of service of this order to arrange or pay any charge for shipping, or to pay any servicer or truck travel or similar charge, in order to obtain performance under any written warranty.

VII

It is further ordered, That respondents shall, within thirty (30) days of the date of service of this order, send to each current distributor and retailer of respondents' consumer products, a copy of this order together with the attached notice.

VIII

It is further ordered, That respondents and their successors and assigns shall maintain for at least four (4) years after the date of each record's generation, and upon request shall make available to the Federal Trade Commission for inspection and copying, the following records as to each consumer who purchases a consumer product with a written warranty offered or issued by any respondent, its successor or assign, or its officer, agent, representative or employee, directly or through any corporation, subsidiary, division or other device:

a. The name and address of the consumer;

b. The name of the dealer from whom the product is purchased; and

c. For each request for service or other action under any such written warranty or under any implied warranty, and for each complaint concerning any such written warranty or any implied warranty, whether submitted in writing or orally:

i. A description of the problem, the action requested, the firm or firms receiving the request or complaint, and the date or dates of receipt;

ii. A copy or description of all replies given to the request or complaint, and by whom; a description of all actions taken, and by whom, in response to the request or complaint; and the date of each such reply and of each such action;

iii. A description of any payment sought from a consumer, the reason for seeking the payment, and the amount received from the consumer, if any; and

iv. Any later service requested or complaint made by or on behalf of the consumer concerning the product.

IX

It is further ordered, That respondents shall distribute a copy of this order to all of respondents' divisions and to all present and future officers, agents, representatives, and employees of respondents having responsibilities with respect to the subject matter of this order.

X

It is further ordered, That the corporate respondents shall notify the Commission at least thirty (30) days prior to any proposed change such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporate respondent which may affect compliance obligations arising out of the order.

XI

It is further ordered, That respondent Stanley Kraftsow shall promptly notify, as described herein, the Commission of any discontinuance of his present business or employment and of his affiliation with any new business or employment, and that, for a period of ten (10) years from the date of service on him of this order, respondent Stanley Kraftsow shall promptly notify, as described herein, the Commission of each affiliation with a new business or employment whose activities include the offering or issuance of written warranties, or of his affiliation with any new business or employment in which his own duties and responsibilities involve offering or issuance of written warranties. Such notice shall include respondent Stanley Kraftsow's new business address and a statement of the nature of the business or employment in which respondent Kraftsow is newly engaged as well as a description of respondent Kraftsow's duties and responsibilities in connection with the business or employment.

XII

It is further ordered, That respondents shall, within sixty (60) days after service upon them of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with this order.

ATTACHMENT TO ORDER

TO ALL OUR DISTRIBUTORS AND DEALERS

Craftmatic has recently signed an agreement with the Federal Trade Commission concerning our warranty policies. A copy of that agreement is attached for your information. The discussion below summarizes the agreement and tells you how the agreement affects you.

WARRANTY PERFORMANCE ON WARRANTIES NOW IN THE FIELD

We have agreed that we are responsible for making sure these warranties are fully and promptly honored, even where one of you has sold the product. Under the terms of our arrangement with you, you are responsible for providing full and prompt performance of these warranties. You should understand that when you handle these warranties, you do so as our representative, and we are required to make sure they are handled properly. We will keep you informed of all our policies and procedures for handling claims for these warranties.

We have also agreed to make sure that any outstanding warranty claims from any of your customers are properly taken care of within 30 days after we learn of such a claim. Please help us handle these claims, for any customer in your area.

In addition we have agreed that certain records about warranty performance under the outstanding Craftmatic warranty will be kept. You need to keep these records for your customers who receive that warranty. We are sure that these records will assist you in performing under the warranty and accounting for your performance should that ever become necessary. As to each customer you have sold, please keep:

The customer's name and address.

A record of each request for service or other action under warranty, and of each warranty complaint, regardless of whether it is made orally or in writing, including:

A description of the problem, what the customer asked for, and the date you received the request or complaint;

A copy or description of every reply made, and the date;

A description of every action taken about the matter, and the date;

Any charge (whether or not collected): the reason for the charge and the amount collected;

If the request or complaint was received or handled in any way by Craftmatic (Pennsylvania) or any other firm, similar records of such receipt and handling; and

Any later requests for service or complaints by or on behalf of that customer.

Keep in the file any letters you receive and a copy of any letters you send.

ISSUANCE OF FUTURE WARRANTIES

As you know, under our agreement with you, you have always been responsible to your customers for full and prompt performance of their warranties. We have decided that in the future any warranties on the products you sell will clearly state they are offered not by Craftmatic but by you. You will be responsible to your customers for performance of those warranties. We will only warrant the products we sell to our retail customers.

We plan to rewrite the warranty to make it clear that the warrantor, the only firm obligated to honor the warranty, is the selling dealer in each case. A sample copy of the revised warranty document is enclosed.

Of course, if you have a problem with a claim for warranty performance that you cannot handle comfortably, please feel free to contact us. We will still do our utmost to help you resolve the problem.

We also suggest that you continue to keep records like those described above for customers to whom you offer your warranty. Such records can assist you in ongoing performance of your warranty.

WARRANTY AVAILABILITY BEFORE SALE

We have agreed to give a copy of our warranty, at the sales presentation, to every customer who buys from us.

We have also agreed to include a copy of our warranty in every pitch book we send you, and to add to the sales pitch and sales materials we send you a statement that the warranty is available for customers to read before buying our products. You should know that, under federal law, door-to-door sellers must bring copies of any warranties on the products they sell to the sales presentation, and must disclose, both orally and in any written materials, that the customer can read the warranties before buying. We have enclosed revised sales materials that include the statement and the warranty itself. You should let us know how many sets of materials you need. Also, you must be sure to make these disclosures in every sales call.

ADVERTISING AND BROCHURE

We are revising our advertisements and sales materials to delete any impression that we offer a warranty on the products sold by selling dealers other than us. We have agreed that, if we make any reference in these materials to a warranty, we will make it clear who actually gives the warranty. You should be careful also, in your sales presentations, not to let your customers think that the warranty is from Craftmatic.

Also, we have agreed that, if we discuss a warranty in our brochure, New Dimensions in Bedroom Luxury, we will disclose any warranty term requiring customers with warranty claims to return the defective part at their cost. This would apply to any other mailers that discuss a warranty as well. We have enclosed samples of the revised brochure.

TRANSPORTATION CHARGES

We have agreed not to charge for transportation or truck travel for any warranty service needed, for beds now in the field. Since you do warranty service under our old warranty, this means that you will not be able to make those charges either. Beds sold after the date of this agreement are not subject to this restriction.

[signature]

Enclosures

IN THE MATTER OF

ALLIED CORPORATION, ET AL.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT AND SEC. 7 OF THE CLAYTON ACT

Docket C-3157. Complaint, June 17, 1985—Decision, June 17, 1985

This consent order with Allied Corporation and King Radio Corporation requires Allied to divest the King Weather Radar Line to Narco Avionics, Inc., or another Commission-approved purchaser. With certain exceptions, the order also prohibits Allied, for a period of ten (10) years, from acquiring, without the Commission's prior approval, any interest in any company that manufactures or sells general aviation weather detection systems in the United States.

Appearances

For the Commission: *Stephen W. Riddell, Sandra G. Wilkof, Laurie T. Baulig* and *John C. Weber.*

For the respondents: *Brian D. Forrow,* in-house counsel, Morris Township, N.J. and *C. Benjamin Crisman, Jr.* and *Peter E. Greene, Skadden, Arps, Slate, Meagher & Flom,* Washington, D.C., for respondent Allied Corporation, and *Owen M. Johnson* and *Paul B. Hewitt, Akin, Gump, Strauss, Hauer & Feld,* Washington, D.C., for respondent King Radio Corporation.

COMPLAINT

The Federal Trade Commission, having reason to believe that respondent, Allied Corporation ("Allied"), has acquired respondent, King Radio Corporation ("King"), both corporations subject to the jurisdiction of the Commission, and that such acquisition constitutes a violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. 45 and that a proceeding in respect thereof would be in the public interest, hereby issues its complaint, stating its charges as follows:

I. DEFINITIONS

1. For purposes of this complaint, the following definitions shall apply:

(a) *General aviation aircraft* means those aircraft predominantly used for private purposes rather than (i) for military purposes or (ii) for the transport of people or cargo for a fee.

(b) *Airborne weather detection system* means (i) a product designed for use in aircraft consisting of a display, a sensor device and an antenna, that uses radio waves to detect and display weather conditions and is designed to enable a pilot to evaluate and avoid adverse weather conditions, or (ii) a product designed for use in aircraft, consisting of a receiver system that detects lightning and is designed to enable a pilot to evaluate and avoid adverse weather conditions. *Airborne weather detection system* shall also include any device that performs the same function in the same manner as the King products designated KGR 356 and KGR 358 for display on the products, defined in (b)(i) and (b)(ii) above.

II. ALLIED

2. Allied is a corporation organized under the laws of New York with its executive offices at Columbia Road and Park Avenue, Morris Township, New Jersey.

3. Allied is a major worldwide supplier of industrial chemicals, petroleum and natural gas, scientific laboratory instruments, typesetting equipment, semiconductor components, automotive parts and aviation and aerospace products.

4. The Bendix Aerospace Sector of Allied develops and manufactures products used in military and civil aircraft, spacecraft, missiles and other defense and space exploration products.

5. In 1983, Allied had sales of $10.02 billion, assets of $7.65 billion, and net income of $98 million.

III. KING

6. King is a corporation organized under the laws of Kansas with its executive offices at 400 North Rogers Road, Olathe, Kansas.

7. King is primarily engaged in the design, manufacture and distribution of electronic communication, navigation, weather radar and flight control equipment for general aviation aircraft.

8. In 1983, King's sales amounted to approximately $86 million, and it had about $76 million in assets.

IV. JURISDICTION

9. At all times relevant herein, respondent, Allied, and respondent, King, have been and are now engaged in commerce as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. 12, and are corporations whose businesses are in or affecting commerce as "commerce" is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. 44.

V. THE ACQUISITION

10. On or about September 26, 1984, Edward King, Chairman of the Board and founder of King entered into a stock purchase agreement to sell his 47.5% share of voting stock in King to AC Acquisition Corporation, a wholly-owned subsidiary of Bendix, itself a subsidiary of Allied. In addition, a trustee for a trust which controls a 6.2% interest in King agreed to sell that interest to AC Acquisition. Pursuant to another agreement AC Acquisition would be merged into King. The total acquisition, which has been valued at $109.8 million, was consummated on January 31, 1985.

VI. TRADE AND COMMERCE

11. The relevant market in which to evaluate the effects of this acquisition is the manufacture and sale, in the United States and worldwide, of airborne weather detection systems designed for use in general aviation aircraft.

12. Allied and King are actual, direct competitors in the manufacture and sale, in the United States and throughout the world, of airborne weather detection systems designed for use in general aviation aircraft.

VII. EFFECTS OF THE ACQUISITION

13. The effects of the acquisition of King by Allied may be substantially to lessen competition or to tend to create a monopoly in the relevant market in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. 18, and Section 5 of the Federal Trade Commission Act as amended, 15 U.S.C. 45 because, *inter alia:*

(a) Substantial direct competition between Allied and King in the relevant line of commerce will be eliminated;

(b) Already high concentration in the relevant line of commerce will be increased, thereby increasing the likelihood of successful collusive behavior among the remaining firms in the relevant line of commerce; and

(c) King will be eliminated as a significant independent competitive influence on the relevant lines of commerce.

VIII. VIOLATION CHARGED

14. The acquisition of the stock of King by Allied violates Section 7 of the Clayton Act, as amended, 15 U.S.C. 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. 45.

DECISION AND ORDER

The Federal Trade Commission, having initiated an investigation of the acquisition of King Radio Corporation ("King") by the Allied Corporation ("Allied"), and Allied and King having been furnished thereafter with a copy of a draft complaint which the Bureau of Competition proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge Allied and King with violations of the Clayton Act and Federal Trade Commission Act; and

Allied, King, their attorneys, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by Allied and King of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by Allied and King that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that Allied and King have violated the said Acts, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of sixty (60) days, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following Order:

1. Allied is a corporation organized, existing and doing business under and by virtue of the laws of New York with its executive offices at Columbia Road and Park Avenue, Morris Township, New Jersey.
2. King is a corporation organized, existing and doing business under and by virtue of the laws of Kansas with its executive offices at 400 North Rogers Road, Olathe, Kansas.
3. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of Allied and King, and the proceeding is in the public interest.

ORDER

For purposes of this order, the following definitions shall apply:

(A) *Allied* means Allied Corporation, its predecessors, divisions, subsidiaries, groups and affiliates controlled by Allied and their respective directors, officers, employees, agents and representatives and their respective successors and assigns.

(B) *King Radio* means King Radio Corporation, its predecessors, divisions, subsidiaries, groups and affiliates controlled by King Radio and their respective directors, officers, employees, agents and representatives and their respective successors and assigns.

(C) *King Weather Radar Line* means all airborne weather detection systems currently manufactured, sold or owned by King Radio, including but not limited to the KWX 565 and the KWX 58 weather radar systems; all airborne weather detection systems that King Radio has under development, including but not limited to the KWX 57, the KWX 460, and improvements or modifications to the KWX 56 or KWX 58 systems; and any other plans or research related to airborne weather detection systems. The KWX 56 and the KWX 58 weather radar systems shall be construed to include, respectively, the KI 244 and the KI 248 control/indicators, the KA 126 and the KA 128 combined antenna/receiver/transmitter units and the KGR 356 and the KGR 538 graphics interface units.

(D) *Airborne weather detection system* means (1) a product, consisting of a display, a sensor device and an antenna, that uses radio waves to detect and display weather conditions and is designed to enable a pilot to evaluate and avoid adverse weather conditions and is designed for use in aircraft; or (2) a receiver system designed for use in aircraft that detects lightning and is designed to enable a pilot to evaluate and avoid adverse weather conditions. *Airborne weather detection system* shall also include any device that performs the same function in the same manner as the King Radio products designated KGR 356 and KGR 358 for display on the products, defined in D (1) and D (2) above.

(E) *Piece Parts* are components and raw materials purchased or made by King Radio for use in manufacturing, producing or repairing the King Weather Radar Line or spare parts. *Kits* are all Piece Parts required to assemble a specific quantity of the King Weather Radar Line.

I.

It is ordered, That:

(A) Within eight (8) months from the date this order becomes final, Allied shall divest, absolutely and in good faith all of the assets described below, so as to transfer the King Weather Radar Line as a viable product line such that a purchaser could compete as a manufacturer and seller of airborne weather detection systems:

(1) All inventories, including Piece Parts, Work-In-Process, finished

goods and kits solely dedicated to the King Weather Radar Line, as determined pursuant to a physical inventory to be taken approximately seven (7) days in advance of the closing of the sale, except that Allied may retain, at its discretion, sufficient quantities of Finished Goods and spare parts as to be able to service, maintain and repair its products in the field and fulfill those contracts not assignable to the purchaser.

(2) All tooling, whether or not in the custody of vendors, and test equipment, including fixtures thereof, solely dedicated to the King Weather Radar Line.

(3) All know-how, and trade secrets, if any, solely dedicated to the King Weather Radar Line, including one patent (no. 3973145) and one patent application (no. 412913).

(4) All engineering and design drawings, including but not limited to all documentation for software contained in or used in the manufacture of the King Weather Radar Line; all documentation related to a new weather radar antenna/receiver/transmitter unit that is in the early development stage; all documentation related to a design for a test adapter to enable the testing of the KGR 356 and KGR 358 graphics interface units utilizing an Apple Computer; and all other documentation, design and development studies, inventory, models and all other data related to the King Weather Radar Line.

(5) All processes, bills of material, maintenance manuals, pilots' guides, TSO reports, advertising literature and brochures solely dedicated to the King Weather Radar Line; vendor and distribution lists; and documentation related to a sales history and marketing of the King Weather Radar Line to the extent that such documentation is separable from other confidential information not related to the King Weather Radar Line.

(6) All purchase orders for Piece Parts on order to the extent that they are assignable and solely dedicated to the King Weather Radar Line, all customer lists for King Weather Radar Line products and all contracts for the sale of King Weather Radar Line to the extent that they are assignable.

(B) Divestiture of the King Weather Radar Line shall be made to Narco Avionics, Inc. pursuant to the terms of the Agreement of Purchase and Sale attached hereto as Exhibit A, or to such other purchaser or purchasers that receive(s) the prior approval of the Commission and only in a manner that receives prior approval of the Commission.

(C) For a period of ninety (90) days following the divestiture of the King Weather Radar Line, or such longer period (not to exceed six (6) months) as agreed between the purchaser and Allied, Allied shall assist the purchaser in the start-up and manufacturing process of the King Weather Radar Line by making personnel available to train and educate employees of the purchaser selected by it in all facets of the start-up, manufacture, production and repair of the King Weather Radar Line. Allied shall name a single technical coordinator to serve as the focal point for such technical assistance. For such technical assistance, Allied may assess the purchaser an amount in accord with the terms of the Agreement of Purchase and Sale attached hereto as Exhibit A, or may charge the purchaser an amount not to exceed its cost for the time and materials (plus a reasonable material burden rate) involved, plus its reasonable travel, lodging and subsistence costs, if any.

(D) Pending the divestiture of the King Weather Radar Line required by this Order, Allied shall use its best efforts to advertise, promote, manufacture and sell the King Weather Radar Line at substantial present levels. Allied shall also continue to fund all ongoing research and development projects with regard to the King Weather Radar Line at 1984 levels. Allied shall be required to designate an appropriate King Radio employee to be responsible for managing the King Weather Radar Line pending its divestiture.

(E) Pending the divestiture of the King Weather Radar Line required by this order, Allied and King shall maintain the viability, integrity and marketability of the properties described in Paragraph I (A) and shall not use or permit the destruction, removal or impairment of any assets to be divested except in the ordinary course of business and except for ordinary wear and tear.

II.

It is further ordered, That, for a period of ten (10) years from the date this order becomes final, Allied shall not, without the prior approval of the Commission, directly or indirectly, acquire any stock, share capital or equity interest in any concern engaged in, or any assets used in the manufacture and sale in or to the United States, of airborne weather detection systems designed for use in general aviation aircraft; *provided, however*, that nothing in this order shall prohibit Allied from (i) acquiring, for investment purposes only, an interest of not more than one (1) percent of the stock, share capital or equity of any such concern; or (ii) making purchases, in the ordinary course of business, of components and equipment used to manufacture airborne weather detection systems (*e.g.*, tools, test equipment and components). For the purposes of this Paragraph, the term *general aviation aircraft* means those aircraft predominantly used for private purposes rather than (i) for military purchases or (ii) for the transport of people or cargo for a fee.

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III.

It is further ordered, That if Allied has not accomplished the divestiture required by Paragraph I of this order within the eight-month period, Allied shall consent to the appointment of a trustee who shall have the power and authority to accomplish the divestiture at the most favorable price and terms available consistent with this order's unconditional obligation to divest. The trustee shall be a person with experience and expertise in acquisitions and divestitures and shall be selected by the Commission subject to Allied's consent, which shall not be unreasonably withheld. The trustee shall serve at the cost and expense of Allied based on reasonable and customary terms. The trustee's compensation shall be based on reasonable and customary terms. The trustee's compensation shall be based at least in significant part on a commission arrangement contingent on the trustee divesting the trust assets. The trustee shall have the cooperation of Allied in accomplishing the divestiture within a reasonable period not to exceed ten (10) months and subject to the prior approval of the Federal Trade Commission. The appointment of a trustee shall not preclude the Commission from seeking civil penalties and other relief available to it for any failure by Allied to comply with Paragraphs I through VI of this order.

IV.

It is further ordered, That within sixty (60) days from the date on which this order becomes final and the first two sixty (60) day periods thereafter and every ninety (90) days thereafter until Allied has fully complied with the provisions of Paragraph I of this order, Allied shall submit in writing to the Commission a verified report setting forth in detail the manner and form in which it intends to comply, is complying or has complied with that provision of this order. All such compliance reports shall include a summary of all discussions and negotiations with any persons who are potential purchasers of the assets to be divested as specified in Paragraph I of this order, including the identity of all such persons, copies of all written communications to and from such persons, and all internal memoranda, reports and recommendations concerning divestiture.

V.

It is further ordered, That for a period of ten (10) years from the date on which this order becomes final, Allied shall notify the Commission at least thirty (30) days prior to any proposed corporate changes that may affect compliance obligations arising out of this order, such as dissolution, assignment or sale resulting in the emergency of successor corporations and the creation or dissolution of subsidiaries.

VI.

On the first anniversary of the date this order becomes final and on every anniversary date thereafter for the following nine (9) years, Allied shall submit to the Commission a verified written report setting forth the manner and form in which it has complied or is complying with this order.

EXHIBIT A*

AGREEMENT OF PURCHASE AND SALE

THIS AGREEMENT made and entered on this 23rd day of January, 1985 (the "Agreement") by and between Narco Avionics, Inc., a Delaware corporation, with its principal offices at 270 Commerce Drive, Fort Washington, Pennsylvania 19034 ("Buyer") and King Radio Corporation, a Kansas corporation, with its principal offices at 400 North Rodgers Road, Olathe, Kansas 66062 ("Seller").

Buyer desires to purchase from Seller, and Seller desires to sell to Buyer, on the terms and conditions set forth herein, a portion of the assets used in the business and operations of Seller set forth in paragraph 1 below, which has been generally identified by Seller as its Weather Radar Product Line and Graphics Interface Product Line, more particularly described as:

(a) All Airborne Weather Detection Systems currently manufactured, sold or owned by Seller, including but not limited to:

(1) The KWX 56 Weather Radar System consisting of the KA 126 Antenna/Receiver/Transmitter and the KI 244 Control/Indicator;

(2) The KWX 58 Weather Radar System consisting of the KA 128 Antenna/Receiver/Transmitter and the KI 248 Control/Indicator;

(3) The KGR 356 Graphics Interface Unit; and

(4) The KGR 358 Graphics Interface Unit;

(b) All Airborne Weather Detection Systems that Seller has under development, including but not limited to the KWX 57 and KWX 460, and improvements or modifications to the KWX 56 or KWX 58 systems; and

(c) Any other plans or research related to Airborne Weather Detection Systems.

all of which to be sometimes hereinafter referred to individually as the "Products", and collectively (including the items set forth in paragraph 1) as the "Product Lines".

In consideration of the mutual covenants, agreements, representations and warranties hereinafter contained, the parties agree as follows:

1. *Purchase and Sale.*

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* Material which the Commission has granted confidential treatment has been replaced in the text with the symbol [***].

At the closing (the "Closing") as hereinafter defined in paragraph 3.1(a), Seller shall sell, transfer and convey to Buyer, and Buyer shall purchase and accept:

(a) *Inventories*. All inventories, including Piece Parts, Work-In-Process, Finished Goods and Kits solely dedicated to the Product Lines subject to the provisions of paragraph 1.1 and 1.2.

(b) *Tooling and Test Equipment*. All tooling, whether or not in the custody of vendors and test equipment including fixtures thereof, solely dedicated to the Product Lines, as set forth in *Exhibit 1(b)*.

(c) *Industrial Property Rights*. All know-how, and trade secrets, if any, solely dedicated to the Product Lines, one patent (no. 3973145), one patent application (no. 412913). Copies of the assignment of the patent and patent application are annexed to this Agreement as *Exhibit 1(c)*.

(d) *Documents, Lists and Design Data*. All engineering and design drawings including but not limited to processes, bills of material, maintenance manuals, pilots' guides, TSO reports, advertising literature and brochures solely dedicated to the Product Lines; vendor and distribution lists; all documentation for software contained in or used in the manufacture of the Products; all documentation related to a new weather radar antenna/receiver/ transmitter unit that is in the [***] developmental stage; all documentation related to a design for a test adapter to enable testing of the KGR 356 and KGR 358 graphics interface units utilizing [designated equipment]; all other documentation, design and development studies, inventory, models and other data related to the Products; and documentation related to a sales history and marketing of the Product Lines to the extent that such documentation is separable from other confidential information not related to the Product Lines.

(e) *Purchase Orders and Contracts*. All purchase orders for Piece Parts on order to the extent that they are assignable and solely dedicated to the Product Lines, all customer lists for the Product Lines and all contracts for the sale of Products to the extent that they are assignable, as set forth in *Exhibit 1(e)* to be provided at the Closing.

1.1 *Limitation on Inventory*. Anything to the contrary notwithstanding, Buyer, at its election, shall not be obligated to purchase, accept and pay for Piece Parts in excess of those necessary to manufacture more than a cumulative total of [***] Weather Radar Products and, in addition thereto, a cumulative total of [***] Graphics Interface Products.

1.2 *Retention by Seller*.

(a) Anything to the contrary notwithstanding, Seller shall retain and not convey to Buyer all Piece Parts, purchase orders for Piece Parts not solely dedicated to the Product Lines, and purchase orders for Piece Parts solely dedicated to the Product Lines that are not assignable after efforts are made to request such vendors to permit such assignment from Seller to Buyer. Seller shall also retain and not convey to Buyer contracts for the sale of spare parts, and for Products that are not assignable after efforts are made to request such vendors to permit such assignment from Seller to Buyer. Seller shall also retain the right to continue to conduct business with vendors and distributors set forth on the vendor and distributor lists. Seller shall also retain and not convey to Buyer a sufficient quantity of Finished Goods and spare parts, in Seller's discretion, as to be able to service, maintain and repair its Products in the field and fulfill any contracts not assignable to Buyer.

(b) Buyer shall grant to Seller a nonexclusive, irrevocable, royalty free license (including the right to grant sublicenses) (i) under the patent and patent application to be conveyed herein, to make, have made, use, and sell Piece Parts and (ii) to utilize the tooling (in the custody of vendors) to be conveyed herein, only as necessary for Seller to service, maintain and repair the Products sold by Seller to third parties prior to the

Closing. Such license shall be for the duration of any patents that are in existence or may be issued that are conveyed herein, and for the life of the tooling. The license to be used is set forth as *Exhibit 1(c)*, annexed to this Agreement.

1.3 *Definitions*. As used herein the following terms apply:

(a) "Finished Goods" shall mean each completed Product.

(b) "Piece Parts" shall mean components and raw material purchased or made by Seller for use in manufacturing, producing, maintaining or repairing the Products or spare parts.

(c) "Kits" shall mean all required Piece Parts to assemble a specific quantity of the Products.

(d) "Work-In-Process" shall mean Products in various stages of manufacture or production.

(e) The phrase "solely dedicated to the Product Lines" in connection with assets to be conveyed herein, shall mean those assets which have no use or value to Seller in connection with its business other than for the Product Lines.

(f) "Weather Radar Products" shall mean the KWX 56 and KWX 58 weather radar systems.

(g) "Graphics Interface Products" shall mean the KGR 356 and KGR 358 Graphics Interface units.

(h) "Airborne Weather Detection System" shall mean (1) a product, consisting of a display, a sensor device and an antenna, that uses radio waves to detect and display weather conditions and is designed to enable a pilot to evaluate and avoid adverse weather conditions and is designed for use in aircraft; or (2) a receiver system designed for use in aircraft that detects lightning and is designed to enable a pilot to evaluate and avoid adverse weather conditions. "Airborne Weather Detection System" shall also include any device that performs the same function in the same manner as the Seller's products designated KGR 356 and KGR 358 for display on the products defined in (h)(1) and (h)(2) above.

2. *Purchase Price*. The purchase price shall consist of a payment made at the Closing as set forth in paragraph 2.1 below, payments or credits as set forth in paragraph 2.2 below, and payments made over a period of seven years as set forth in paragraph 2.3 below.

2.1 *Current Payment*. At the Closing, Buyer shall pay to Seller as part of the purchase price, [* * *]. Such payment shall be made by certified check or wire transfer at the election of the Seller.

2.2 *Payments and Credits*.

(a) Buyer shall also pay to Seller, as part of the purchase price, a sum [* * *] for Finished Goods on hand at the Closing (and in the production process) to be conveyed to Buyer, plus [***] of such costs for variance factors, and a sum [* * *] for its Kits, Piece Parts and Work-In-Process on hand at the Closing (and in the production process) to be conveyed to Buyer, plus [***] of such costs as a material burden rate.

(b) The Buyer shall receive a credit of [* * *] which credit shall be deducted from sums due Seller under paragraph 2.2(a). The net amount due Seller after deduction of the credit shall be payable in accordance with the terms of paragraph 2.2(c).

(c) Such sums due Seller pursuant to paragraph 2.2(b) shall be payable in principal increments of [* * *] ninetieth (90th) day following the Closing Date, and on each ninetieth (90th) day thereafter, until fully paid, in accordance with a promissory note bearing a rate of interest of [***] per annum in the form set forth as *Exhibit 2.2(c)* annexed to this Agreement. If less than [***] is due Seller, the full sum shall be paid to Seller on the ninetieth (90th) day following the Closing Date, plus interest due. In the event an adjustment in the cost of inventory that was in production is necessary, such an adjustment shall be made pursuant to paragraph 4.7.

2.3 *Additional Payments.*

(a) In addition, Buyer will pay, as part of the purchase price, the sum of [* * *] with interest at [***] per annum, payable in 27 equal installments of [***] and a final installment of [* * *] in accordance with an unsecured promissory note set forth in *Exhibit 2.3(a)*. Payments shall commence on the ninetieth (90th) day following the final payment due under the promissory note set forth in *Exhibit 2.2(c)*, and shall continue on each ninetieth (90th) day thereafter, until fully paid.

3. *The Closing.*

3.1 *Closing.* The purchase and sale of the Product Lines contemplated by this Agreement and the assignment, conveyance and transfer thereof by Seller to Buyer, and payment, delivery of a promissory note, execution of a license agreement, guarantees, security interests, and performance of other obligations as set forth in this Agreement, which are considered conditions of Closing, shall take place at: the offices of Allied Bendix Aerospace, 1000 Wilson Boulevard, Arlington, Virginia 22209, at such time and date to be mutually agreed upon after appropriate approvals are obtained from the FTC pursuant to the FTC investigation, or at such other time and place as the parties may agree to in writing ("Closing Date").

3.2 *Instruments of Transfer.* At the Closing, Seller will deliver to Buyer an Assignment and Bill of Sale, passing all right, title and interest in and to the Product Lines free and clear of all liens, security interests and other encumbrances in the form set forth in *Exhibit 3.2*, annexed to this Agreement.

4. *Standard Costs, Physical Inventory Count and Transfer of Inventory.*

4.1 The inventories, including Finished Goods, Kits, Piece Parts and Work-In-Process have been valued at [* * *] in accordance with Seller's accounting practices.

4.2 Within approximately seven days prior to the Closing, Seller and Buyer together, will count the inventory on hand, not committed to production, (including test counts and sample counts, where total counting is impractical), and establish an agreed upon quantity which will be valued at Seller's cost plus [***]. Seller and Buyer will supervise the packaging and sealing of the cartons of such inventory. The quantities as established will not be subject to adjustment, since Buyer will have partaken in the inventories count and sealing of such cartons.

4.3 Seller will continue production until approximately one day prior to Closing. An estimated amount of inventory in production will be established and valued at Seller's cost plus [***].

4.4 At the Closing, the cost of inventory on hand (plus [***]) and the cost of the estimated inventory in production (plus [***]) will serve as the basis of payment pursuant to the promissory note described in paragraph 2.2*(c)*.

4.5 As soon as practicable after the Closing Date, per agreement of the parties, the inventory on hand (not in production) will be shipped to Buyer on a carrier designated by Buyer, f.o.b. Seller's plant.

4.6 Within thirty (30) days after the Closing, as soon as practicable, Seller will gather up the inventory that was in production (possibly in three plants) and place it in a central location at Seller's plant. Seller and Buyer will count the inventory that was in production and will supervise the packaging and sealing of the cartons of such inventory, which will be valued at Seller's cost (plus [***]). The quantities established will not be subject to adjustment.

4.7 An adjustment between the estimated quantity of inventory that was in production given at the Closing by Seller, and the actual quantity of such inventory will be made, if required, and such adjustment in terms of costs will be reflected in a new promissory note to be executed by Buyer containing the same terms as set forth in *Exhibit 2.2(c)* (except for the adjustment in principal), which new promissory note shall bear interest at [***] from the Closing Date, and the original note will be destroyed.

4.8 The inventory in production will be shipped to Buyer as soon as practicable after packaging it, on a common carrier designated by Buyer, f.o.b. Seller's plant.

4.9 Buyer will, in its discretion, within forty-five days from the Closing Date, examine the valuation of the inventory at Seller's cost (plus [***]) to determine whether Seller accurately and consistently applied its standard costs to the inventory. Adjustments, if necessary, in terms of costs will be reflected in the new promissory note. The new promissory note will be substituted for the original promissory note as set forth in *Exhibit 2.2(c)* and delivered to Seller within sixty days after the Closing Date.

4.10 Seller will take reasonable steps to secure the inventory while it is in Seller's custody. The risk of loss shall pass from Seller to Buyer in accordance with the terms set forth in paragraph 11.14.

4.11 In the event Buyer and Seller do not agree on the quantity of the inventories or the consistency or accuracy of the application of the valuation of such inventories, then the issues involved in the dispute shall be referred to an auditor to be mutually agreed upon, and such auditor shall perform an independent review of the facts in order to resolve specific issues. The determination of such auditor shall be final with respect to the matters in dispute. All costs associated with such auditor shall be shared equally by Buyer and Seller.

4.12 Any payments received by Seller in error for purchases made from Buyer by Buyer's customers after the Closing Date, will be endorsed over to Buyer or remitted to Buyer.

5. *Representations and Warranties of Seller.*

5.1 *Organization.* Seller is a corporation duly organized, validly existing and in good standing under the laws of the State of Kansas and has all necessary corporate power and authority to own, lease and operate its properties and to carry on its business and the business of the Product Lines as now being conducted. No party, other than Seller, has any right, title or interest, or to the knowledge of Seller, has asserted any such right, title, or interest, in and to the Product Lines.

5.2 *Authority.*

(a) At the Closing Seller will have the full corporate power and authority to enter into this Agreement and to carry out the transactions contemplated hereby, and all proceedings required to be taken by Seller to authorize the execution, delivery and performance of this Agreement have been properly taken and this Agreement constitutes a valid and binding obligation of Seller enforceable in accordance with its terms. Other than an investigation of the Federal Trade Commission ("FTC") regarding the acquisition by The Bendix Corporation ("Bendix") of Seller's voting stock, which investigation may determine that Seller be required to dispose of the Product Lines that are the subject of this Agreement to a Buyer to be approved by the FTC (hereinafter referred to as the "FTC Investigation"), there is no litigation, proceeding, or investigation pending, or to the best of Seller's knowledge threatened, which questions the validity or enforceability of this Agreement or seeks to enjoin the consummation of any of the transactions contemplated hereby.

(b) Other than the FTC Investigation and agreements between the FTC, Bendix and/or Seller that may have been entered into pursuant to such investigation, neither the execution and delivery hereof, nor the consummation of the transactions contemplated hereby, nor compliance by Seller with any of the provisions hereof will (1) conflict with or result in a breach of or default under any of the terms, conditions or provisions of any agreement, instrument or obligation to which Seller is a party, related to the Product Lines, or by which it or its properties and assets may be bound or affected or (2) result in violation of any order, writ, injunction, decree, statute, rule or regulation applicable to Seller or the Product Lines.

5.3 *Inventories, etc.* The inventories of Seller regarding the Product Lines on the Closing Date will consist of items of a quality and quantity usable and salable in the ordinary course of business as it was conducted by Seller during the past year. Such inventories have been valued at [* * *] in accordance with the normal inventory valuation practices of the Seller for the Product Lines. The market value of the tooling and test equipment, cumulatively to be conveyed herein equals or exceeds [* * *]. The value of the inventories to be conveyed to Buyer will exceed [* * *].

5.4 *Brokers and Finders.* Seller has not retained any broker or finder or paid or agreed to pay any broker's or finder's fee or commission for or on account of the transactions contemplated by this Agreement.

5.5 *Manufacturing Capability.* The assets of the Product Lines conveyed by Seller herein contain sufficient information, data and other assets for Seller to be able to manufacture the Products. Seller does not guarantee that Piece Parts conveyed herein (exclusive of the Kits) are sufficient to allow full assembly of individual Products.

5.6 *Gross Margin.* The Gross Margin on Weather Radar Products, in accordance with Seller's standard accounting practices over the past year, on average, has not been less than [***], as reported in Seller's monthly Cost of Sales Reports.

5.7 *Product Values.* Except as stated in this subparagraph Seller has no knowledge of any circumstances which would make the Product Lines obsolete or diminish the market for the Product Lines taken as a whole. The parties understand, however, that the KWX 58 Product may diminish the sales of the KWX 56 Product and the KGR 358 Product may diminish the sales of the KGR 356 Product, and the parties further understand that the markets may naturally diminish by virtue of Buyer being a new entrant into the marketplace.

5.8 *Disclosure.* No representation or warranty by Seller in this Agreement, and no statement, certificate or other document furnished, or to be furnished, by or on behalf of Seller under this Agreement, and the Exhibits hereto, contains or will contain any untrue statement of material fact or intentionally omits any material fact necessary to make the statements contained herein or therein not misleading.

6. *Representations and Warranties of Buyer.* Buyer represents and warrants to Seller as follows:

6.1 *Organization.* Buyer is a corporation duly organized, validly existing, and in good standing under the laws of the State of Delaware and has all necessary corporate power and authority to conduct its business as such business is now being conducted, and to own its property and the Product Lines.

6.2 *Authority.* At the Closing Buyer will have full corporate power and authority to enter into this Agreement and carry out the transactions contemplated hereby; all proceedings required to be taken by it to authorize the execution, delivery and performance of this Agreement have been properly taken; and this Agreement constitutes a valid and binding obligation of Buyer enforceable in accordance with its terms.

6.3 *Brokers and Finders.* Buyer has not retained any broker or finder or paid or agreed to pay any broker's or finder's fee or commission for or on account of the transactions contemplated by this Agreement.

6.4 *Litigation or Proceedings*

(a) Other than the FTC investigation, there is no litigation, proceedings, or investigation pending, or to the best of Buyer's knowledge threatened, which questions the validity or endorsement of this Agreement or seeks to enjoin the consummation of any of the transactions contemplated hereby.

(b) Neither the execution and delivery hereof, nor the consummation of the transactions contemplated hereby, nor compliance by Buyer with any of the provisions hereof, will result in violation of any order, writ, injunction, decree, statute, rule or regulation applicable to Buyer.

6.5 *Collateral.* The collateral given to secure payment of sums due under paragraph 2.2 herein is valued at approximately $1,200,000.00, and other than Seller's lien to be placed thereon, is and will contain only one prior lien, to wit, a first mortgage held by The Crocker Bank in a sum not to exceed $650,000.00, there being sufficient remaining equity to secure payments under paragraph 2.2 herein. Buyer will offer to Seller a second mortgage on the collateral set forth in paragraph 11.3 to secure such payments.

6.6 *Disclosure.* No representation or warranty by Buyer in this Agreement, and no statement, certificate or other document furnished or to be furnished by or on behalf of Buyer under this Agreement, and the Exhibits hereto, contains or will contain any untrue statement of material fact or intentionally omits any material fact necessary to make the statements contained herein or therein not misleading.

7. *Conditions Precedent to Buyer's Performance.* All obligations of Buyer to consummate the transactions as contemplated by this Agreement are subject to the fulfillment of each of the following conditions at or prior to Closing (unless waived in writing by Buyer):

7.1 All representations and warranties of Seller contained herein, and in any document delivered pursuant hereto, shall be true and correct in all material respects when made and as of the Closing.

7.2 All obligations required by the terms of this Agreement to be performed by Seller shall have been duly and properly performed in all material respects and Buyer shall have received a certificate, dated the Closing Date, signed by an officer of Seller to such effect.

7.3 Seller shall have delivered to Buyer a certified copy of a resolution adopted by the Board of Directors of Seller authorizing the execution, delivery and performance of this Agreement.

7.4 There shall have been no change in the Product Lines, except changes in the ordinary course of business none of which shall have been materially adverse to any Product.

7.5 There shall not have been any legal action or other proceedings brought by third parties to restrain or prohibit the consummation of the transactions contemplated by this Agreement, or to obtain other relief in connection with this Agreement, or the transactions contemplated hereby, nor shall any such actions be pending or threatened.

7.6 The FTC shall have approved this transaction in a final order of a consent decree and shall have permitted the acquisition by Bendix of Seller's voting stock, or in the alternative, the FTC shall have affirmatively indicated that no consent decree is required.

7.7 The FTC shall have approved Buyer as a party to this transaction.

7.8 Buyer shall have received from counsel for Seller a written opinion dated as of the Closing Date, addressed to Buyer, in a form and substance to be mutually agreed upon by Buyer's and Seller's counsel.

8. *Conditions Precedent to Seller's Performance.* All obligations of Seller to consummate the transactions as contemplated by this Agreement are subject to the fulfillment of each of the following conditions at or prior to the Closing (unless waived in writing by Seller):

8.1 All representations and warranties of Buyer contained herein, and in any document delivered pursuant hereto, shall be true and correct in all material respects when made and as of the Closing.

8.2 All obligations required by the terms of this Agreement to be performed by Buyer shall have been duly and properly performed in all material respects and Seller shall have received a certificate, dated the Closing Date, signed by an officer of Buyer to such effect.

8.3 Buyer shall have delivered to Seller a certified copy of the resolution adopted by the Board of Directors of Buyer authorizing the execution, delivery and performance of this Agreement.

8.4 There shall not have been any legal action or other proceedings brought by third parties to restrain or prohibit the consummation of the transactions contemplated by this Agreement, or to obtain other relief in connection with this Agreement, or the transactions contemplated hereby, nor shall any such actions be pending or threatened.

8.5 The FTC shall have approved this transaction in a final order of a consent decree and shall have permitted the acquisition by Bendix of Seller's voting stock, or in the alternative, the FTC shall have affirmatively indicated that no consent decree is required.

8.6 The FTC shall have approved Buyer as a party to this transaction.

8.7 Seller shall have received from counsel for Buyer a written opinion dated as of the Closing Date, addressed to Seller, in a form and substance to be mutually agreed upon by Buyer's and Seller's counsel.

9. *Indemnification.*

9.1 *Seller's Indemnity.*

(a) Seller shall indemnify and hold harmless Buyer, for a period of one year from the Closing Date, against any damage, loss, cost, liability or expense (including reasonable attorneys' fees), which arise out of or result from (a) the incorrectness or breach of any of the representations or warranties of Seller contained in this Agreement, or given in writing on the Closing Date, and (b) the failure on the part of Seller to perform any convenants or agreements on its part to be performed.

(b) Buyer shall give Seller prompt written notice of any matter which may give rise to Buyer's right to indemnity hereunder. Such notice shall identify the nature of the matter and, if appropriate, the persons making the claim from which Buyer's rights to indemnity may arise. Prior to the settlement of any claim, or the defense of any litigation with a third party which may give rise to indemnity hereunder, Seller shall be given the opportunity to participate in negotiation and settlement discussions or assume the defense of such litigation, as the case may be. Any claim of indemnification made hereunder shall include a statement specifying the nature and amount of the damages, losses, costs, liabilities and expenses incurred by Buyer, for which indemnification is claimed hereunder.

9.2 *Buyer's Indemnity.*

(a) Buyer shall indemnify and hold harmless Seller, for a period of one year (except for the payments due under this Agreement, which period of indemnification shall be seven years) from the Closing Date, against any damage, loss, cost, liability or expense (including reasonable attorneys' fees), which arise out of or results from (a) the incorrectness or breach of any of the representations or warranties of Buyer contained in this Agreement, or given in writing on the Closing Date, and (b) the failure on the part of Buyer to perform any covenants or agreements on its part to be performed.

(b) Seller shall give Buyer prompt written notice of any matter which may give rise to Seller's right to indemnity hereunder. Such notice shall identify the nature of the matter and, if appropriate, the persons making the claim from which Seller's rights to indemnity may arise. Prior to the settlement of any claim or the defense of any litigation with a third party which may give rise to indemnity hereunder, Buyer shall be given the opportunity to participate in negotiation and settlement discussions or assume the defense of such litigation, as the case may be. Any claim of indemnification made hereunder shall include a statement specifying the nature and amount of the damages, losses, costs, liabilities and expenses incurred by Seller, its successors or assigns, for which indemnification is claimed hereunder.

10. *Nature and Survival of Representations and Warranties.* All statements contained in this Agreement and in any certificate, instrument, or document delivered by or on behalf of either of the parties pursuant hereto shall be deemed representations and warranties by the respective parties hereunder. All representations and warranties made hereunder shall survive the Closing for a period of one year from the Closing Date.

11. *General Provisions*

11.1 *Guarantees.* At the Closing, Buyer shall have obtained and delivered to Seller, a Guarantee by Edward M. Zimmer, Jr., in his personal capacity, and not as an officer of Narco, that Edward M. Zimmer, Jr. shall be and remain primarily liable as a guarantor of any payments due Seller under this Agreement. Such Guarantee shall be in the form annexed to the promissory notes.

11.2 *Accelerated Schedule.* On a best efforts basis, Seller, on the signing of this Agreement up to the Closing Date, shall accelerate its schedule of manufacturing Products and Kits to a reasonable rate as determined by Seller in excess of its current rate of production.

11.3 *Collateral.* Buyer shall offer the following collateral as security to secure all sums due Seller under the promissory note set forth in paragraph 2.2(c), and shall execute at the Closing all documents reasonably required by Seller to enable Seller to perfect its security interest in the collateral.

Collateral: A commercial building owned by Edward M. Zimmer, Jr., Trust, located on Monroe Avenue, Houston, Texas valued at approximately $1.2 million, the appraisal to be supplied at Closing.

11.4 *Allocation of Payments.* Seller and Buyer agree that the purchase price shall be allocated in accordance with *Exhibit 11.4.*

11.5 *Product Support, Product Liability.*

(a) Buyer shall be responsible for supporting all Products and spare parts sold by it to Buyer's customers, including repairs to Products and spare parts, whether or not under warranty, and shall be responsible for and, upon the Closing, automatically assume the costs and expenses, including expenses affiliated with the defense of lawsuits and claims, that arise in connection with Products and spare parts sold by Buyer to its customers.

(b) Seller shall be responsible for supporting all Products and spare parts sold by it to Seller's customers, including repairs to Products and spare parts, whether or not under warranty, and shall be responsible for and, upon the Closing, automatically assume the costs and expenses, including expenses affiliated with the defense of lawsuits and claims, that arise in connection with Products and spare parts sold by Seller to its customers. Sales of Products and spare parts by Seller to Buyer, in connection with this transaction shall not be deemed a sale to Seller's "customer", and accordingly, Buyer and not Seller shall be responsible for and, upon the Closing, shall automatically assume the Product support, repairs, costs, and expenses, including the expenses affiliated with lawsuits and claims, that arise in connection with Products and spare parts, if any, sold by Seller to Buyer as part of this transaction. Sales of Products from Seller to Buyer as part of this transaction shall be serialized and identified at the Closing in *Exhibit 11.5(b).* Anything to the contrary notwithstanding, after consummation of this transaction, in the event Seller purchases Products or spare parts from Buyer to support Seller's Products in the field, or for systems installations, Buyer shall extend to Seller the same warranty it offers to its other customers.

11.7 *Technical Assistance.* Seller shall assist Buyer in the start-up and manufacturing process of the Product Lines by making personnel available to train and educate employees of Buyer in all facets of the start-up, manufacture, production and repair of the Products and the transfer of Seller's research and development concerning the Products. The individual employees of Seller and the number of such employees made available for such technical assistance shall be determined by the Seller. A single technical coordinator shall be named by Seller to serve as the focal point for such technical assistance. Such technical assistance shall be made available, as may be required by Buyer, for a period of [* * *] following the Closing (but may be extended by mutual consent of the parties). Such technical assistance for [* * *] following the Closing shall be made available as part of the purchase price and is valued by the parties at [***]. Any technical assistance rendered by Seller to Buyer, per agreement of the parties, after such [* * *] period shall be paid for by Buyer on a time and material basis, for the costs incurred by Seller, [* * *] for each labor hour expended by Seller's personnel in rendering technical assistance. In addition, for technical assistance rendered after the [* * *] the Buyer shall pay to Seller the cost of material paid for or expended by Seller [* * *] related to the technical assistance. Such technical assistance may be rendered at Seller's or Buyer's plant or at other places to be mutually agreed upon. Buyer shall pay all reasonable costs expended for transportation, lodging and subsistance of Buyer's and Seller's personnel involved in the technical assistance program when travel away from home is required. Seller shall invoice Buyer for such technical assistance, costs and expenses and such invoices shall be due and payable within thirty days after receipt thereof.

11.8 [* * *]

11.9 *Sale Made "As Is, Where Is".* The sale of the Product Lines is made on an "as is, where is" basis which shall be reflected in the Assignment and Bill of Sale.

11.10 *"King" Name.*

(a) The Buyer shall not utilize the "King" name and logo in the manufacture, marketing, distribution and sale of products, except to indicate in its advertising literature and brochures, for a period not to exceed three years from the Closing Date, that the Products were "formerly manufactured by King Radio Corporation". Buyer shall have the exclusive use of the nomenclature KWX 56, KWX 58, KGR 356, KGR 358, KA 128, KI 244 and KI 248 for the Product Lines acquired hereunder. All tooling shall be modified by Buyer to remove the King name and logo, and such name and logo shall be removed by Buyer from all Products and Piece Parts manufactured by Buyer. With respect to Products manufactured by Seller and sold to Buyer, as part of this transaction for subsequent resale to Buyer's customers, Buyer shall place a permanently affixed label on such products indicating that they were sold by Buyer.

(b) The "King" name and logo shall not be placed on the front panel of Airborne Weather Detection Systems for a period of seven years from the Closing Date. Anything to the contrary notwithstanding, Seller will be permitted to advertise "Bendix" weather radar equipment together and in connection with Seller's non-weather radar equipment, provided further that Seller will not identify "King" as the source of manufacture of any weather radar except as required by law.

11.11 *Further Assurances and Cooperation.* In connection with the transactions contemplated by this Agreement, the parties agree to execute such additional documents and papers, and perform and do such additional acts and things as may be reasonably necessary or proper to effectuate and carry out all of the provisions and the intent of this Agreement.

11.12 *Notices.* All notices to be given by either party to this Agreement to the other party hereto shall be in writing and shall be given in person or by depositing such notice in the United States mail, registered or certified, postage prepaid addressed as follows (unless either party designates a different address in writing to the other party for communicating notices):

To Buyer: Narco Avionics, Inc.
270 Commerce Drive
Fort Washington, PA 19304
Attention: President

With a carbon copy to:

Edward M. Zimmer, Jr.
Post Office Box 277
Laguna Beach, CA 92652

To Seller: King Radio Corporation
400 North Rodgers Road
Olathe, KS 66062
Attention: President

With a carbon copy to:

Allied Bendix Aerospace
1000 Wilson Boulevard
Arlington, VA 22209
Attention: General Counsel

11.13 *Payment of Expenses, Taxes and Closing Costs.* Each of the parties shall pay all costs and expenses incurred or to be incurred by it in negotiating and preparing this Agreement and in closing and carrying out the transactions contemplated hereby. All sales taxes and like taxes payable in connection with the sale, conveyances, assignments, transfers and deliveries to be made to Buyer hereunder, shall be borne by the Buyer.

11.14 *Deliveries and Risk of Loss.* The Product Lines to be conveyed by Seller to Buyer pursuant to the Agreement shall be delivered f.o.b. Seller's factory, 400 North Rodgers Road, Olathe, Kansas to Buyer, or to a private or common carrier acceptable to Buyer, for delivery to premises designated by Buyer, as soon after the Closing as practicable. Irrespective of the date upon which such Product Lines are delivered to Buyer, or to a private or common carrier, and notwithstanding any agreement, express or implied, that Seller and Buyer may enter into for Seller to hold or store such Product Lines on a temporary basis for Buyer after the Closing, the risk of loss, damage or destruction of such Product Lines shall pass from Seller to Buyer on the Closing Date, immediately after consummation of such Closing.

11.15 *Announcements.* No public or other announcement, including any press releases regarding this Agreement, or the transactions contemplated hereby, shall be made by either Seller or Buyer without advance notice to and prior approval by the other party which notice shall include the text of such announcement or release.

11.16 *Entire Agreement.* This writing constitutes the entire Agreement of the parties with respect to the subject matter hereof and may not be modified, amended or terminated except by a written agreement specifically referring to this Agreement and signed by the parties hereto.

11.17 *Waiver.* No waiver of any breach or default hereunder shall be considered valid unless in writing and signed by the party giving such waiver, and no such waiver shall be deemed a waiver of any subsequent breach or default of the same or similar nature.

11.18 *Successors and Assigns.* This Agreement shall be binding upon and inure to the benefit of each of the parties hereto, and their successors and assigns.

11.19 *Severability.* If any clause or provision of this Agreement shall be held invalid or unenforceable by the final determination of a court of competent jurisdiction, and all appeals therefrom shall have failed or the time for such appeals shall have expired, such clause or provisions shall be deemed eliminated from this Agreement but the remaining provisions shall nevertheless be given full force and effect.

11.20 *Captions.* The paragraph headings contained herein are for the purpose of convenience and are not intended to define or limit the contents of said paragraphs.

11.21 *Choice of Law.* This Agreement shall be construed, interpreted and enforced in accordance with the laws of the State of Kansas.

IN WITNESS WHEREOF, the parties have duly executed this Agreement as of the day, month and year first above written.

KING RADIO CORPORATION
By: Louis J. Giuliano
Vice President & Group Exe.
Bendix Aerospace Sector

NARCO AVIONICS, INC.
By: Edward M. Zimmer, Jr.
President

EXHIBIT 1(b)

Radar Tooling

THIS IS CONFIDENTIAL MATERIAL

EXHIBIT 1(c)

ASSIGNMENT

WHEREAS, King Radio Corporation, a Kansas corporation, located at 400 North Rodgers Road, Olathe, Kansas, hereinafter "Assignor," is sole owner of and desires to formally assign to Assignee the U.S. Letters Patent and Patent Application listed below; and having conveyed certain tooling in an Assignment and Bill of Sale dated, __________, to Assignee: and

WHEREAS, Narco Avionics, Inc., a Delaware corporation located at 270 Commerce Drive, Fort Washington, Pennsylvania 19034, hereinafter "Assignee", desires to acquire the entire right, title and interest in and to said U.S. Letters Patent and Patent Application, subject to the grant to the Assignor of certain license rights therein; and desires to acquire the right, title and interest to tooling set forth in an Assignment and Bill of Sale dated __________ from Assignor to Assignee, subject to the grant, to the Assignor of certain license rights in such tooling;

UNITED STATES PATENT

Patent No.	Issue Date	Title	Inventor
3973145	August 3, 1976	Weather Radar Transistorized Pulse Modulator	Jerry C. Schmitt Terry K. Michie

UNITED STATES PATENT APPLICATION

Serial No.	Filing Date	Title	Inventor
412913	August 30, 1982	Apparatus and Method for the Correction of Attenuation Induced Errors In a Weather Radar Receiver	James Lyall

NOW, THEREFORE, THIS DEED WITNESSETH: that for and in consideration of One Dollar ($1.00) to Assignor in hand paid and other good and valuable consideration, the receipt of which is hereby acknowledged, that Assignor has sold, assigned, transferred and set over, and by these presents does hereby sell, assign, transfer and set over unto the said Assignee, the entire right, title and interest in and to said U.S. Letters Patent and Patent Application, and any reissues or extensions thereof, together with all rights to recover for past infringements thereof, subject to the grant to the Assignor of an non-exclusive, irrevocable, royalty-free, license, with rights to sublicense, to make, have made, use and sell Piece Parts under said U.S. Letters Patent and Patent Application and any reissues or extensions thereof, for the life of the patent and any patent issued under the Patent Application listed herein, the same to be held and enjoyed by Assignee, for its own use and benefit and for the use and benefit of its successors, assigns and legal representatives, subject to the license granted herein.

Furthermore, Assignee grants to Assignor the license and right to use tooling in the custody of vendors to make, have made, use and sell for itself and its successors and assigns, certain Piece Parts from said tooling in the custody of vendors, for the life of such tooling, which tooling was conveyed to Assignee pursuant to an Assignment and Bill of Sale dated ________, from Assignor to Assignee.

IN WITNESS WHEREOF, the Assignor and Assignee hereunto set their respective hands and affixed their respective seals, this ________ day of ________, 1985 by their duly authorized representatives.

Attest:
____
Title:
(Seal)

KING RADIO CORPORATION, Assignor
By: ________________________
Title: ________________________

Attest:
____
Title:
(Seal)

Narco Avionics, Inc., Assignee
By: ________________________
Title: ________________________

ATTESTATION FOR ASSIGNOR

County of ________________
State of ________________

On this ________ day of ____________, 1985, before me personally appeared ____________, to me personally known, who being by me duly sworn, did say that he is ____________ of King Radio Corporation, the Assignor above-named and acknowledged that he executed the foregoing instrument on behalf of said Assignor and pursuant to authority duly received.

____
Notary Public
My Commission Expires: ____________
(Seal)

ATTESTATION FOR ASSIGNEE

County of ______________________
State of ______________________

On this ________ day of ____________, 1985, before me personally appeared ______________, to me personally known, who being by me duly sworn, did say that he is ____________ of Narco Avionics, Inc., the Assignee above-named and acknowledged that he executed the foregoing instrument on behalf of said Assignee and pursuant to authority duly received.

____
Notary Public
My Commission Expires: ____________
(Seal)

EXHIBIT 2.2(c)

PROMISSORY NOTE

$____________ Date____________

For value received, the undersigned, Narco Avionics, Inc., a Delaware corporation, ("Narco") promises to pay to the order of King Radio Corporation, a Kansas corporation, ("King") the principal sum of $________ payable with interest as hereinafter provided at the offices of King Radio Corporation, 400 North Rodgers Road, Olathe, Kansas 66062, Attention: Chief Financial Officer, or at such other place as the holder may designate in writing. The principal of this Note is payable in ________ equal installments of [* * *] and one final installment of the principal balance due, with such installment payments commencing on the ninetieth (90th) day from the date hereof, and each following installment due ninety (90) days following the previous payment date, until fully paid.

Interest on the unpaid principal balance of this Note shall accrue from the date hereof at the rate of [***] percent per annum. Accrued interest shall be payable from time to time on the dates for payments of installments of principal as herein provided. The undersigned shall have the right to prepay all or any part of this Note without penalty.

Any amounts not paid as herein provided shall bear interest at the rate of [***] percent per annum. Default in the payment of any part of the principal or interest, when due, shall, at the option of the holder hereof, at once mature the whole of the principal and interest due under this Note, without notice to the maker, endorsors, or guarantors, if any.

It is expressly agreed that if suit is brought on this Note, or if collected through bankruptcy, insolvency, or other judicial proceedings, the holder hereof shall be entitled to recover all reasonable expenses incurred in connection with such collection, suit or proceedings, including reasonable attorney's fees and legal expenses.

The undersigned and all endorsers and guarantors hereby waive presentation for payments, notice of payment extensions, protest, notice of protest, and diligence in bringing suit against any maker, endorser or guarantor, hereof. The endorsers shall also waive notice of default and nonpayment, but Narco and any guarantors shall be entitled to a notice of default and nonpayment, in writing, and shall have ten (10) days from the receipt of such notice to cure the default and nonpayment.

NARCO AVIONICS, INC.
By ____________________
Seal Authorized Officer

GUARANTEE

The undersigned, Edward M. Zimmer, Jr., in his personal capacity, and not as an officer of the maker of the above Note, shall be primarily liable for payments due under the above Note, and hereby guarantees to the holder of the above Note, prompt payment of all sums which shall become due to the holder pursuant to the foregoing Promissory Note whether or not extended by the parties to the above Note, and hereby waives, with respect to the above Note, notice of payment extensions, protest, notice of protest, and diligence in bringing any suit against any maker, endorser or guarantor of the above Note, and further agrees to remain primarily liable in the event the terms of payment of principal or interest are extended under the Note. Edward M. Zimmer, Jr. shall be entitled to notice of default and nonpayment in writing and shall have ten (10) days from receipt of such notice to cure such default and nonpayment.

____
Edward M. Zimmer, Jr.
Individually

EXHIBIT 2.3(a)

PROMISSORY NOTE

[* * *] Date: __________

For value received, the undersigned, Narco Avionics, Inc., a Delaware corporation, ("Narco") promises to pay to the order of King Radio Corporation, a Kansas corporation, ("King") the principal sum of [* * *] payable with interest as hereinafter provided at the offices of King Radio Corporation, 400 North Rodgers Road, Olathe, Kansas 66062, Attention: Chief Financial Officer, or at such other place as the holder may designate in writing. The principal of this Note is payable in 27 equal installments of [***] each, and one final installment of [***] with such installment payments commencing on the ninetieth (90th) day from the date following the final payment due under a promissory note of same date as herein from Narco to King given pursuant to an Agreement of Purchase and Sale dated __________, and each following installment due ninety (90) days following the previous payment date, until fully paid.

Interest on the unpaid principal balance of this Note shall accrue from the date hereof at the rate of [***] percent per annum. Accrued interest shall be payable from time to time on the dates for payments of installments of principal as herein provided. The undersigned shall have no right to prepay all or any part of this Note without the written consent of King.

Any amounts not paid as herein provided shall bear interest at the rate of [***] percent per annum.

It is expressly agreed that if suit is brought on this Note, or if collected through bankruptcy, insolvency, or other judicial proceedings, the holder hereof shall be entitled to recover all reasonable expenses incurred in connection with such collection, suit or proceedings, including reasonable attorney's fees and legal expenses.

The undersigned and all endorsers and guarantors hereby waive presentation for payments, notice of payment extensions, protest, notice of protest, and diligence in bringing suit against any maker, endorser or guarantor, hereof. The endorsers shall also waive notice of default and nonpayment, but Narco and any guarantors shall be entitled to a notice of default and nonpayment, in writing, and shall have ten (10) days from the receipt of such notice to cure the default and nonpayment.

NARCO AVIONICS, INC.
By ______________________
Seal Authorized Officer

GUARANTEE

The undersigned, Edward M. Zimmer, Jr., in his personal capacity, and not as an officer of the maker of the above Note, shall be primarily liable for payments due under the above Note, and hereby guarantees to the holder of the above Note, prompt payment of all sums which shall become due to the holder pursuant to the foregoing Promissory Note whether or not extended by the parties to the above Note, and hereby waives, with respect to the above Note, notice of payment extensions, protest, notice of protest, and diligence in bringing any suit against any maker, endorser or guarantor of the above Note, and further agrees to remain primarily liable in the event the terms of payment of principal or interest are extended under the Note. Edward M. Zimmer, Jr. shall be entitled to notice of default and nonpayment in writing and shall have ten (10) days from receipt of such notice to cure such default and nonpayment.

____
Edward M. Zimmer, Jr.
Individually

EXHIBIT 3.2

ASSIGNMENT AND BILL OF SALE

KNOW ALL MEN BY THESE PRESENTS:

That, King Radio Corporation, a Kansas corporation ("Transferor"), for good and valuable consideration paid to Transferor by Narco Avionics, Inc., a Delaware corporation ("Transferee"), receipt of which is hereby acknowledged, and in accordance with the terms of an Agreement of Purchase and Sale, dated as of ________, 1985 between Transferor and Transferee (the "Purchase Agreement"), by these presents does hereby sell, convey, transfer and assign unto Transferee, its successors and assigns, the following assets of Transferor on an "as is, where is" basis:

(a) *Inventories.* Inventories, including Piece Parts, Work-In-Process, Finished Goods and Kits set forth in an inventory list annexed hereto, subject to adjustment within thirty (30) days after the Closing Date in accordance with an Agreement of Purchase and Sale dated ________, between Transferor and Transferee.

(b) *Tooling and Test Equipment.* Tooling, and test equipment including fixtures thereof, as set forth in *Exhibit 1(b)* annexed hereto, subject to a license and right by Transferor to make, use and have made Piece Parts utilizing the tooling in the custody of vendors, for the life of such tooling.

(c) *Industrial Property Rights.* All know-how, and trade secrets, if any, solely dedicated to the Product Lines, and one patent (no. 3973145), one patent application (no.

412913) pursuant to an Assignment of such patent and patent application (subject to a license to Seller) set forth in *Exhibit 1(c)* annexed hereto.

(d) *Documents, Lists and Design Data.* All engineering and design drawings in reproducible form, including processes, bills of material, maintenance manuals, pilots' guides, TSO reports, advertising literature and brochures solely dedicated to the Product Lines; vendor and distribution lists; applicable documentation for software contained or related to the manufacture of the Weather Radar Products; documentation as it exists related to a new antenna/receiver/transmitter unit that is in the [***] developmental stage; documentation related to a design for a test adapter to enable testing the Graphics Interface Products utilizing [designated equipment], other design and development studies and documentation related to the Products; studies, documentation, inventory, models and all other data related to weather radar units under development if any, including but not limited to the KWX 57 and KWX 460 projects; and documentation related to a sales history and marketing of the Product Lines to the extent that such documentation is separable from other confidential information not related to the Product Lines.

(e) *Purchase Orders and Contracts.* All purchase orders for Piece Parts and all contracts for the sale of Products as set forth in *Exhibit 1(e)* annexed hereto.

TO HAVE AND TO HOLD the same to Transferee, its successors and assigns, forever.

1. Transferor does for itself and for its successors and assigns, covenant to Transferee, its successors and assigns that Transferor is the sole owner of all of the assets which are to be sold and conveyed to Transferee hereunder and Transferor has all necessary power and authority to sell and convey such assets to Transferee, and that such assets are free and clear of all mortgages, liens, and encumbrances of any nature which are not of record.

2. Transferor agrees that, at any time and from time to time after the date hereof, it will, upon the request of Transferee, execute and deliver all such further documents and take all such further action as may be required for the better conveyance, transfer and assignment of the assets, properties and rights intended to be conveyed, transferred and assigned hereby.

3. This instrument and the covenants and agreements contained herein shall be binding upon Transferor, its successors and assigns and shall inure to the benefit of Transferee, its successors and assigns.

IN WITNESS WHEREOF, King Radio Corporation has executed this instrument in its corporate name by its duly authorized officer as of ________, 1985.

KING RADIO CORPORATION

SEAL By ____________________

EXHIBIT 11.4

Purchase Price Allocation

THIS IS CONFIDENTIAL MATERIAL

In the Matter of

MIDDLE ATLANTIC CONFERENCE

DISMISSAL ORDER IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket 9185. Complaint, Sept. 18, 1984—Order Dismissing Complaint, June 27, 1985

The Federal Trade Commission has dismissed the complaint in this matter since the collective ratemaking activities of respondent are immunized by the state action doctrine. The Commission has found that "further prosecution of this matter does not appear to be in the public interest."

Complaint

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Middle Atlantic Conference, a corporation, hereinafter sometimes referred to as "respondent," has violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges as follows:

For the purposes of this complaint the use of the present tense includes the past tense and the following definitions apply:

Carrier means a common carrier of property by motor vehicle.

Intrastate transportation means the pickup or receipt, transportation and delivery of property for compensation wholly within any State of the United States by a carrier authorized by that state to engage therein.

Tariff means a publication and any supplements thereto stating the rates of a carrier for the intrastate transportation of property, excluding general rules and regulations.

Member means any carrier or other person that pays dues or belongs to Middle Atlantic Conference or to any successor corporation.

Rate means a charge, payment or fixed price according to a ratio, scale or standard for direct or indirect transportation service.

Collective rate means any rate or charge established under any contract, agreement, understanding, plan, program, combination or conspiracy between two or more competing carriers, or between any carrier and respondent.

Paragraph 1. Respondent, Middle Atlantic Conference, is a corporation organized, existing and doing business under and by virtue of the laws of the District of Columbia, with its office and principal place of business located at 6410 Kenilworth Avenue, Riverdale, Maryland. Respondent publishes and issues tariffs containing rates for the intrastate transportation of property on behalf of its member carriers.

PAR. 2. Carriers engaging in intrastate transportation of property within Pennsylvania do so under certificates of public convenience and necessity granted by the Pennsylvania Public Utilities Commission. Such carriers are subject to rate regulation by the said Commission and are required to charge just and reasonable rates. Carriers in Pennsylvania are required to charge the rates filed once they have been accepted by the said Commission.

PAR. 3. The statute which provides for regulation of carriers engaged in the intrastate transportation of property within Pennsylvania does not compel, command, authorize or otherwise provide for the establishment, operation or continuation of collective rates among carriers or others on their behalf.

PAR. 4. Except to the extent that competition has been restrained as herein alleged, respondent's members are now in competition among themselves and with other carriers.

PAR. 5. Respondent's membership consists of approximately 100 carriers engaging in intrastate transportation of property within Pennsylvania. Respondent's members are entitled to and do, among other things, vote for and elect the officers and directors of respondent. The control, direction and management of respondent are vested in the Board of Directors, which employs a general manager who acts as chief administrative officer of the corporation with direct charge of and supervision over the affairs of the corporation.

PAR. 6. The acts and practices of respondent set forth in Paragraph Eight are in or affecting commerce as "commerce" is defined in the Federal Trade Commission Act, as amended, and respondent is subject to the jurisdiction of the Federal Trade Commission. Respondent's acts and practices:

(A) Affect the flow of substantial sums of money across state lines from businesses and other private parties to respondent's members for rendering intrastate transportation services;

(B) Affect respondent's members' purchase and use of equipment and other goods and services which are shipped across state lines; and

(C) Are supported by the receipt of dues and fees which are sent across state lines.

PAR. 7. Shippers use the intrastate services of respondent's members to transport property from warehouses and distribution centers in Pennsylvania to customers in Pennsylvania, which property was originally shipped into Pennsylvania from other states. For such intrastate deliveries of property from warehouses and distribution centers, carriers charge shippers or shippers' customers the intrastate rates published by respondent. These intrastate shipping charges are factors which influence the prices of such property. The intrastate delivery services of these carriers are an essential and integral part of the interstate business transactions of such shippers. Thus, the activities of these carriers have a substantial and direct effect upon interstate commerce.

PAR. 8. Respondent, its members, officers, directors, and others are engaging in a combination, conspiracy, agreement, concerted action or unfair and unlawful acts, policies and practices, the purpose or effect of which is to unlawfully hinder, restrain, restrict, suppress or eliminate competition among carriers engaged in the intrastate transportation of property within Pennsylvania.

Pursuant to and in furtherance thereof, respondent, its members and others engage in the following acts, policies and practices, among others:

(A) Initiating, preparing, developing, disseminating, and taking other actions to establish and maintain collective rates for the intrastate transportation of property within Pennsylvania;

(B) Participating in the collective rates; and

(C) Filing collective rates with the Pennsylvania Public Utilities Commission.

PAR. 9. The acts and practices of respondent, its members and others as alleged in Paragraph Eight have the effect of:

(A) Fixing, stabilizing, raising, maintaining, or otherwise interfering or tampering with the rates charged by carriers for the intrastate transportation of property within Pennsylvania;

(B) Restricting, restraining, hindering, preventing or frustrating rate competition among carriers for the intrastate transportation of property within Pennsylvania;

(C) Depriving shippers patronizing carriers for intrastate transportation of property within Pennsylvania of the benefits of free and open competition in the provision of said services; and

(D) Depriving consumers in Pennsylvania of the benefits of free and open competition in the intrastate transportation of property.

PAR. 10. The acts, policies and practices of respondent, its members and others, as herein alleged, are all to the prejudice and injury of the public and constitute unfair methods of competition in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, as amended. The acts and practices of respondent, as herein alleged, are continuing and will continue in the absence of the relief herein requested.

ORDER DISMISSING COMPLAINT

The Commission has considered this matter on complaint counsel's unopposed motion that the complaint be withdrawn.

In this case respondent has argued that its collective ratemaking activities are immunized by the state action doctrine. Complaint counsel now represents that all the elements of a state action defense as articulated by the Supreme Court in *Southern Motor Carriers Rate Conference v. United States*, 105 S.Ct. 1721 (1985), are available to the respondent. Accordingly, further prosecution of this matter does not appear to be in the public interest. The complaint is therefore dismissed.

IN THE MATTER OF

THE ECHLIN MANUFACTURING COMPANY, ET AL.

DISMISSAL ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT AND SEC. 7 OF THE CLAYTON ACT

Docket 9157. Complaint, July 23, 1981—Final Order, June 28, 1985

The Federal Trade Commission has dismissed its antitrust challenge to The Echlin Manufacturing Co.'s acquisition of Borg-Warner Corp.'s automotive-aftermarket operations. The Commission ruled that since there are no barriers to entry into the market for the assembly and sale of carburetor kits, "there can be no anticompetitive effect from the acquisition, and no violation of the antitrust laws."

Appearances

For the Commission: *Ann B. Malester, Karen E. Chandler* and *Linda Martin.*

For the respondents: *Basil J. Mezines, Glenn A. Mitchell* and *David U. Fierst, Stein, Mitchell & Mezines,* Washington, D.C. and *David H. Spiller,* in-house counsel, Branford, Conn., for respondent Echlin Mfg. Co. *Earl E. Pollock, Gary Senner, Louis C. Kieler* and *Blake Harrop, Sonnenschein, Carlin, Nath & Rosenthal,* Chicago, Ill. and *Cheryl Longtin,* in-house counsel, Chicago, Ill., for respondent Borg-Warner Corp.

COMPLAINT

The Federal Trade Commission, having reason to believe that the Respondents, The Echlin Manufacturing Company ("Echlin") and Borg-Warner Corporation ("Borg-Warner"), subject to the jurisdiction of the Commission, have entered into an agreement which violates Section 5 of the Federal Trade Commission Act, as amended, (15 U.S.C. 45); that Echlin has acquired those assets of Borg-Warner described in Paragraph 11 and that such acquisition constitutes a violation of Section 7 of the Clayton Act, as amended, (15 U.S.C. 18) and Section 5 of the Federal Trade Commission Act, as amended; and it appearing that a proceeding in respect thereof would be in the public interest, the Commission hereby issues its Complaint, pursuant to Section 11 of the Clayton Act (15 U.S.C. 21) and Section 5(b) of the Federal Trade Commission Act (15 U.S.C. 45(b)), stating its charges as follows:

I. THE ECHLIN MANUFACTURING COMPANY

1. Echlin is a corporation organized and doing business under the laws of Connecticut, with its principal office at 175 North Branford Road, Branford, Connecticut.

2. For the fiscal year ending August 31, 1980, Echlin's consolidated operating revenues were approximately $301.4 million and its net income was approximately $8.8 million. As of August 31, 1980, Echlin had total assets of approximately $237 million.

3. Echlin's major area of business is the manufacture and sale of replacement automotive parts. Echlin's products include: carburetor kits; carburetor and emission control parts; ignition system parts; automotive diagnostic equipment; turbochargers; hydraulic and air brake parts and assemblies; automotive wire and cable products; clutch and electrical system components used by remanufacturers; and parts for maintaining lift trucks and small gasoline engines. [2]

4. Echlin is engaged in the sale and shipment of products, including carburetor kits, throughout the United States; and is engaged in or affects commerce within the meaning of the Clayton Act, as amended, and the Federal Trade Commission Act, as amended.

II. BORG-WARNER CORPORATION

5. Borg-Warner is a corporation organized and doing business under the laws of Delaware, with its principal office at 200 South Michigan Avenue, Chicago, Illinois.

6. In 1980, Borg-Warner's consolidated manufacturing revenues were approximately $2.7 billion and its net income was approximately $126 million. As of December 31, 1980, Borg-Warner had total manufacturing assets of approximately $1.9 billion.

7. Borg-Warner's major areas of business are the manufacture and sale of transportation equipment, chemicals and plastics, air conditioning equipment, and industrial products. Borg-Warner also has subsidiaries engaged in the business of financial and protective services.

8. In 1980, Borg-Warner's Transportation Equipment Group had sales of approximately $903.6 million and earnings of approximately $31.5 million. The group manufactured and/or supplied products for use in new vehicle production and for replacement use. These products included: carburetor kits; automatic and manual transmissions and transmission components; ignition system parts; individual carburetor and emission control parts; clutches and clutch components; four-wheel drive units; axles; radiators; and automatic slack adjusters. These products are used on passenger cars, trucks, off-highway vehicles, and in farm and marine applications.

9. As of July 13, 1981, all of the divisions of Borg-Warner involved in the manufacture and/or sale of replacement automotive parts were included within the Transportation Equipment Group. Included among such divisions that manufactured and/or sold replacement automotive parts were: the Automotive Parts Division ("APD"); the Ballwin-Washington Division ("Ballwin-Washington"); the Ottawa Division ("Ottawa"); APD International; and APD Borg-Warner (Canada) Limited. APD has been engaged in the sale of a variety of automotive products to the replacement channels of distribution, including: carburetor kits; carburetor and emission control parts; fuel pumps; ignition system parts; automotive wire and cable products; and new and remanufactured clutches. Ballwin-Washington's primary business has been the assembly of carburetor kits and the production of the vast majority of parts therefore. Ottawa remanufactured clutches for sale by APD to the replacement market. APD International and APD Borg-Warner (Canada) Limited exported replacement automotive parts.

10. Borg-Warner has been and is engaged in the sale and shipment of products, including carburetor kits, throughout the United States; and is engaged in or affects commerce within the meaning of the Clayton Act, as amended, and the Federal Trade Commission Act, as amended. **[3]**

III. THE AGREEMENT OF THE PARTIES

11. On May 12, 1981, Echlin and Borg-Warner entered into an agreement, effective February 28, 1981, whereby Echlin would acquire all of the assets of Borg-Warner's automotive aftermarket operations in exchange for 22% of Echlin's common stock. The Boards of Directors of Echlin and Borg-Warner gave their final approval to this transaction and Echlin's stockholders ratified the agreement on July 7, 1981. Pursuant to this agreement, Echlin has acquired the assets of the divisions of Borg-Warner's Transportation Equipment Group set forth specifically in Paragraph 9. In exchange therefor, Borg-Warner acquired approximately 4,500,000 shares of Echlin common stock. The agreement also provides for the election of one Borg-Warner representative to the Echlin Board of Directors so long as Borg-Warner owns at least 10% of Echlin's voting securities. Pursuant to a trademark licensing agreement, Echlin and Borg-Warner have agreed that Echlin will receive an exclusive license to use certain Borg-Warner trademarks in connection with the marketing and sale of various automotive products to the "automotive aftermarket" in the United States and Canada and a non-exclusive license for the rest of the world. In addition, Echlin and Borg-Warner have entered into a supply agreement whereby Borg-Warner will continue to supply

Echlin for at least fifteen years with the products which Borg-Warner's remaining divisions have historically supplied to the Borg-Warner divisions acquired by Echlin. The transaction was consummated on or about July 14, 1981.

IV. NATURE OF TRADE AND COMMERCE

12. The relevant geographic market is the United States as a whole.

13. The relevant product market is the assembly and sale of carburetor kits.

14. A carburetor kit is a prepackaged assemblage of the parts most often replaced on a carburetor. In order to facilitate the use of a carburetor kit, each carburetor kit also contains gauges and an instruction sheet. There is no practical alternative to the use of a carburetor kit.

15. Carburetor kits are used by professional mechanics and, to a limited extent, by vehicle owners themselves. These installers have found that it is easier and cheaper to buy in the form of a carburetor kit all the items which generally need to be replaced on a carburetor. By purchasing a kit, the installer can be assured of obtaining the parts that should be replaced rather than going through the process of deciding whether or not to replace each different part. The installer also saves the time and effort that would be needed to procure all the individual parts. Therefore, installers purchase carburetor kits in preference to the components thereof in the vast majority of instances.

16. Several hundred different carburetor kits are required to provide coverage for virtually all of the vehicles serviced in the United States. Wholesalers usually stock a line of carburetor kits but only limited amounts of some of the individual components included in a kit. This enables the wholesalers to avoid the extra expense of inventorying, warehousing, pulling and billing numerous items for a single repair rather than one carburetor kit.

17. An assembler of carburetor kits performs both an assembly function in creating the carburetor kit and a sales function in selling the carburetor kit directly or indirectly to the replacement channels of distribution. [4]

18. The assembly of carburetor kits consists of determining which parts should be included in each kit, obtaining a source for the thousands of individual carburetor parts, and packaging the parts together with appropriate instructions and gauges.

19. The assembler of carburetor kits must have the necessary skills to determine which items to include in each kit in order to achieve the appropriate level of consolidation that will minimize the number of

kits in a line but still not result in significantly higher per unit prices due to the inclusion of extra parts.

20. All carburetor kit assemblers, including Echlin and Borg-Warner, have supplied carburetor kits directly to the replacement channels of distribution. Prior to July 13, 1981, Borg-Warner also sold carburetor kits to firms which resell such kits to the replacement channels of distribution under their own brand names.

21. There are three channels of replacement parts distribution. Most carburetor kits are sold to warehouse distributors who in turn sell them to jobbers for their resale to installers. A second channel consists of sales to vehicle dealers. A third channel consists of sales to direct buying retailers, *e.g.*, mass merchandisers.

22. New vehicle manufacturers do not purchase carburetor kits for incorporation in new vehicles. Carburetor remanufacturers rarely purchase carburetor kits.

V. MARKET STRUCTURE

23. Sales of carburetor kits by assemblers in 1980 totalled approximately 12.6 million units, having a value of approximately $53 million at the level of sales to the replacement channels of distribution.

24. In 1980, Echlin assembled at least 1.2 million carburetor kits which it sold to the replacement channels of distribution. Echlin accounted for approximately 9.8% of all carburetor kits assembled and sold in the United States in 1980.

25. In 1980, Borg-Warner assembled approximately 4.8 million carburetor kits, making it the largest assembler of carburetor kits and accounting for approximately 38.4% of all carburetor kits assembled and sold in the United States. Borg-Warner sold approximately 1.86 million of these carburetor kits directly to the replacement channels of distribution and sold the remainder to other firms which resold these carburetor kits under their own brand names to the replacement channels of distribution.

26. Concentration in the assembly and sale of carburetor kits is extremely high. In 1980, there were only seven domestic companies that assembled carburetor kits and virtually no imports of carburetor kits. In 1980, two-firm concentration in the assembly and sale of carburetor kits was approximately 63.7% and four-firm concentration was approximately 82.6%.

VI. BARRIERS TO ENTRY

27. The barriers to entry into the assembly and sale of carburetor kits, including the obtaining of carburetor parts, are significant. [5]

VII. ACTUAL COMPETITION

28. Prior to July 13, 1981, Echlin and Borg-Warner were actual competitors in the assembly and sale of carburetor kits in the United States.

VIII. EFFECTS

29. The effect of the aforesaid acquisition may be to substantially lessen competition in the relevant market in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. 45, in the following ways, among others:

(1) it has eliminated actual competition between Echlin and Borg-Warner and between Borg-Warner and others in the assembly and sale of carburetor kits;

(2) it has created one firm accounting for approximately 48% of the relevant market, whose market power in the assembly and sale of carburetor kits vis-a-vis its competitors is greater than that formerly held by either Borg-Warner or Echlin due to the combined firm's role in the assembly of carburetor kits, its degree of vertical integration in parts production for carburetor kits, and its degree of direct sales to the replacement channels of distribution;

(3) it has significantly increased the already high levels of concentration in the relevant market, with two-firm concentration increasing from approximately 63.7% to 73.5%, *pro forma*, and four-firm concentration increasing from approximately 82.6% to 89.2%, *pro forma*, based on 1980 figures; and

(4) it may disadvantage firms supplying carburetor kits directly to the replacement channels of distribution by increasing the likelihood that such firms would be deprived of the access to carburetor kits which such firms currently enjoy.

IX. VIOLATIONS CHARGED

30. The steps taken by Echlin and Borg-Warner to consummate the aforesaid transaction constitute a violation of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. 45.

31. The acquisition of assets set forth in Paragraph 11 constitutes a violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. 45.

INITIAL DECISION BY

MONTGOMERY K. HYUN, ADMINISTRATIVE LAW JUDGE

SEPTEMBER 14, 1984

PRELIMINARY STATEMENT

On July 23, 1981, the Federal Trade Commission ("Commission") issued a Complaint challenging the 1981 acquisition of certain automotive aftermarket assets of Borg-Warner Corporation ("Borg-Warner") by Echlin Inc. ("Echlin") as a violation of Section 5 of the Federal Trade Commission Act, as amended (15 U.S.C. 45), and of Section 7 of the Clayton Act, as amended (15 U.S.C. 18). The Complaint alleges that the relevant product market in which to assess the competitive effect of the acquisition is the "assembly and sale of carburetor kits," and that the acquisition combined two firms with 9.8% (Echlin) and 38.4% (Borg-Warner) of the market. The Complaint alleges that prior to the acquisition, Echlin and Borg-Warner were direct competitors, ranking third and first, respectively, in the relevant product market and that, as a result of the acquisition, Echlin became the dominant firm in the assembly and sale of carburetor kits.

The Complaint further charges that the effect of the acquisition may be to substantially lessen competition in the assembly and sale of carburetor kits. Through its acquisition of Borg-Warner's automotive aftermarket assets, Echlin: (1) eliminated actual competition between itself and Borg-Warner and between Borg-Warner and other carburetor kit assemblers; (2) significantly increased concentration levels in an already highly concentrated market; and (3) created a dominant firm accounting for almost 50% of the market.

Respondents filed their Answers to the Complaint on August 27, 1981, admitting in part and denying in part the various allegations of the Complaint.

Under the supervision and control of my predecessor, Administrative Law Judge John J. Mathias, the parties were allowed an extensive discovery and all pre-trial steps were concluded by June 1983.

On August 16, 1983, the instant case was reassigned to me. Echlin's August 31, 1983 motion to disqualify me pursuant to Section 3.42(g)(2) of the Commission's Rules of Practice, which I certified to the Commission with a statement of reasons for my decision not to disqualify myself, was dismissed by the Commission by Order of September 13, 1983.

Adjudicative hearings began on September 12, 1983 and concluded on April 19, 1984, with 41 days of trial. Testimony was heard from a total of 41 witnesses. (Complaint counsel called 12 witnesses and respondents called 30 witnesses, with one witness called to testify by both complaint counsel and respondents.) Presentation of the case-in-chief began in Washington, D.C. on September 12, 1983 and continued through October 6, 1983. Respondents' defense began in St. Louis, [3] Missouri on October 17, 1983 and continued through October 21, 1983. Respondents' defense resumed on November 7, 1983 in Washington, D.C. and concluded on December 6, 1983. Complaint counsel presented a rebuttal case with hearings held on April 18, 1984 through April 19, 1984. Respondents offered several surrebuttal exhibits that were received in evidence on May 1, 1984. The record, which includes a transcript of 5,327 pages and over 750 exhibits, was closed on May 1, 1984.[1]

References to the record are made in parentheses and the following abbreviations are used:

CPF – Complaint Counsel's Proposed Findings;
CRB – Complaint Counsel's Reply to RPF and RB;
CX – Commission's Exhibit;
RPF – Respondents' Proposed Findings;
RB – Respondents' Memoranda of Law in Support of RPF;
RX – Respondents' Exhibits;
RRB – Respondents' Reply to CPF.
SB – Supplemental Brief of Borg-Warner Corporation
SRB – Supplemental Reply Memorandum of Borg-Warner Corporation

The transcript citation of a witness' testimony is referred to with the last name of the witness and the page number(s) upon which the testimony appears. Other transcript citations are referred to as "Tr." followed by the page number(s).

Definitions

For the purposes of this Initial Decision, the following definitions apply:

(a) The *replacement market* includes all sales by manufacturers of automotive parts for use as replacement of original equipment parts or of previously replaced parts.

(b) The *automotive aftermarket* is used synonymously with the term *replacement market*. [4]

(c) The terms *automotive carburetor kits, carburetor kits* and *carburetor tune-up kits* include kits used to repair carburetors on domestic and foreign automobiles and light trucks, industrial and agricultural equipment and inboard marine engines.

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[1] By order dated May 31, 1984, the Commission extended the due date of this Initial Decision to September 14, 1984.

The proposed findings and conclusions submitted by the parties and their arguments in support thereof have been given careful consideration by me and to the extent not adopted by this Initial Decision, in the form proposed or in substance, are rejected as not supported by the evidence or as immaterial. Any motion appearing on the record not heretofore or hereby specifically ruled upon either directly or by the necessary effect of the conclusions in this Initial Decision are hereby denied.

Upon consideration of the entire record in this proceeding and having considered the demeanor of the witnesses, I make the following findings of fact and conclusions of law and order based on the record considered as a whole:

FINDINGS OF FACT

I. DESCRIPTION OF RESPONDENTS

A. *Respondent Echlin Inc.*

1. Echlin Inc. ("Echlin"), formerly The Echlin Manufacturing Company, is a Connecticut corporation with its headquarters in Branford, Connecticut (CX 235A). It has plants and offices in Connecticut, Illinois, Florida, California, Kansas, Michigan, Missouri and several foreign countries (CX 235G-H). For purposes of this case, the two relevant plants are Branford, Connecticut, where all design, consolidation and sourcing decisions for carburetor parts and kits are made, and Litchfield, Illinois, where the kits are assembled and warehoused (Timberlake 3080–81, 3072). The selling functions are carried out in Branford (Timberlake 3080).

2. Echlin sells numerous automotive aftermarket products, including condensers, contacts, complete distributors, distributor caps, ignition coils, rotors, control modules, pickups, sensors, electronic voltage regulators, ignition wire, automotive testing equipment, hydraulic brake master cylinders, wheel cylinders for drum brake systems, rotors and calipers for disk brake systems, brake repair kits, air brakes, turbochargers, fuel pumps, PCV valves, small engine parts, fork lift truck **[5]** replacement parts, carburetor parts, and carburetor kits (CX 235B; Timberlake 3127; Schultz 3057). Echlin does not produce or sell new or rebuilt replacement carburetors (CX's 235, 534M).

3. Some of these products are manufactured by Echlin; others are sold by Echlin but manufactured by other firms. For example, Echlin does not manufacture the carburetor parts that it sells, either in-

dividually packaged or in the form of kits (Smith 3178–79). For a period of some six to eight months in 1980 and 1981, Echlin manufactured, more or less on an experimental basis, some pump plungers and diaphragms that were included in some carburetor kits but found its costs to be too high and phased out the venture sometime in late 1981 (Smith 3233–35).

4. Approximately 72% of Echlin's automotive aftermarket sales are to the traditional channel of aftermarket distribution, independent warehouse distributors ("WDs") (CX 235C). The remaining 28.2% of the aftermarket sales are to distribution center ("DCs") affiliates of the National Automotive Parts Association ("NAPA") (CX 235C).

5. All products identified with the "Echlin" trade name are sold only to NAPA DCs under the "NAPA-Echlin" name (CX 235D). Among these products are carburetor kits, which are identified as NAPA-Echlin kits and sold only to NAPA (Timberlake 3130).

6. NAPA is a program distribution group (McKenna 3904). It sells automotive parts through 79 distribution centers ("DCs"), owned by Genuine Parts (71 DCs), Quaker City Motor Parts (5 DCs), Britain Brothers (2 DCs), and NAPA-Hawaii (1 DC) (Waters 3298; McKenna 3907). A DC serves essentially the same role as does a WD in the independent aftermarket (Waters 3297).

7. The NAPA DCs distribute parts through about 6,200 jobber stores, of which about 300 are owned by NAPA member companies and about 5,900 are independently owned (McKenna 3907, 3921; Waters 3298).

8. Echlin's carburetor kits bear the dual brand name "NAPA-Echlin" (CX 238, 250; Schultz 3058). These kits are sold only to NAPA (Timberlake 3130; CX 238A). Echlin has never sold, nor tried to sell, carburetor kits to any customer other than NAPA (Waters 3302). Echlin has been the sole source of carburetor kits to NAPA at least since 1970 (McKenna 3911).

9. For the fiscal year ending August 31, 1980, Echlin's consolidated operating revenues were approximately $301.4 million and its net income was approximately $8.8 million. As of August 31, 1980, Echlin had total assets of approximately $237 million (Complaint and Echlin's Answer ¶ 2; CX 231 at 16, 18). **[6]**

10. Echlin is one of the leading manufacturers supplying replacement parts and supplies to the automotive aftermarket in the United States (CX 235D).

11. Because of the emphasis in recent years on fuel economy, pollution control and safety, Echlin's products "are among the fastest growing lines of parts in the replacement market" (CX 231 at 10).

12. Assuming an average carburetor kit price of $3.397 in 1979 (CX

618), Echlin's sales of kits it assembled were [***]* of Echlin's total sales (CX 466"O" *in camera*). Assuming an average kit price of [***] in fiscal 1980 (CX 619B *in camera*), Echlin's sales of kits it assembled were [***] of Echlin's total sales revenues (CX 466Z–5 *in camera*). In 1980, Echlin was the third largest domestic assembler and seller of carburetor kits and accounted for approximately 9.8% of all carburetor kits sold in the United States that year (CX 530A).

13. Echlin is engaged in the sale and shipment of products, including carburetor kits, throughout the United States. Echlin is engaged in commerce, and its acts and practices are in or affecting commerce, within the meaning of the Clayton Act, as amended, and the Federal Trade Commission Act, as amended (Complaint and Echlin's Answer ¶ 4).

B. *Respondent Borg-Warner Corporation*

14. Borg-Warner Corporation ("Borg-Warner") is a corporation organized and doing business under the laws of Delaware, with its principal office at 200 South Michigan Avenue, Chicago, Illinois. (Complaint and Borg-Warner's Answer ¶ 5).

15. In 1980, Borg-Warner and its consolidated subsidiaries had net sales and other revenues totalling approximately $2,689 million and net income of approximately $126 million. As of December 31, 1980, Borg-Warner had total assets of approximately $1.9 billion (Complaint and Borg-Warner's Answer ¶ 6; CX 3Z–5 through Z–6).

16. Borg-Warner is a diversified manufacturing corporation. Its principal product lines include transportation equipment, chemicals and plastics, air conditioning equipment, and other industrial products and services. Borg-Warner's subsidiaries are engaged in the business of providing financial and protective services (Complaint and Borg-Warner's Answer ¶ 7; CX 3Z–22, 4D).

17. In 1980, the Transportation Equipment Group ("T.E.G.") was Borg-Warner's largest business group in terms of sales (CX 4I). T.E.G.'s divisions were engaged in the manufacture **[7]** and/or supply of automotive products to original equipment manufacturers as well as to the replacement market (Complaint and Borg-Warner's Answer ¶ 8). T.E.G. had 1980 sales of approximately $903.6 million and earnings of approximately $31.5 million (Complaint and Borg-Warner's Answer ¶ 8; CX 3Z–13).

18. Prior to the acquisition challenged herein, all Borg-Warner divisions involved in the manufacture and/or sale of replacement automotive parts were included within T.E.G. (Complaint and Borg-Warner's Answer ¶ 9).

19. The products manufactured and/or supplied by Borg-Warner's

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* Throughout this document, [***] refers to *in camera* material that has been excised.

T.E.G. in 1980 included: automatic and manual transmissions and transmission components; ignition system parts; carburetor and emission control parts; carburetor kits; clutches and clutch components; four-wheel drive units; axles; radiators; and automatic slack adjusters. These products are used on passenger cars, trucks, off-highway vehicles, and on farm and marine applications (Complaint and Borg-Warner's Answer ¶ 8; CX 4I).

20. Borg-Warner's sales and earnings by product areas for the period 1976–1980 were as follows (CX 3X):

Sales and earnings by product area (millions of dollars)	1980	1979	1978	1977	1976
Sales					
Air Conditioning	$ 587.3	$ 570.3	$ 516.9	$ 439.2	$ 352.5
Chemicals & Plastics	630.9	595.4	472.1	421.8	399.1
Industrial Products	516.0	467.2	422.4	365.0	343.5
Transportation Equipment	903.6	986.6	844.5	718.5	652.4
Sales of present operations	2,637.8	2,619.5	2,255.9	1,944.5	1,747.5
Discontinued operations	35.5	97.9	70.1	87.4	114.9
	$2,673.3	$2,717.4	$2,326.0	$2,031.9	$1,862.4
Earnings					
Air Conditioning	$ 13.0	$ 12.1	$ 19.6	$ 18.3	$ 9.7
Chemicals & Plastics	28.2	27.7	18.5	6.6	13.2
Financial and Protective Services	35.8	27.3	18.0	12.8	10.6
Industrial Products	52.7	32.4	30.9	26.1	16.2
Transportation Equipment	(5.9)	46.2	42.4	32.0	26.5
Earnings of present operations	123.8	145.7	129.4	95.8	76.2
Discontinued operations	2.3	9.9	4.4	8.2	5.5
	$ 126.1	$ 155.6	$ 133.8	$ 104.0	$ 81.7

21. [***] (CX's 161A, 3Z–1, 24C *in camera*). T.E.G.'s automotive aftermarket operations performed better than its original equipment operations in 1980 and showed an increase in sales over 1979 (CX 3Z–2), although the sales of all [8] transportation equipment, including original equipment sales, showed a substantial decline (CX 3X).

22. In 1980, the year preceding the acquisition challenged herein, Borg-Warner assembled and sold approximately 4.8 million carburetor kits, accounting for about 38.4% of all carburetor kits sold in the United States and ranked first in that market (CX 530A).

23. Borg-Warner has been and is engaged in the sale and shipment of automotive products throughout the United States, and is engaged in commerce, or its acts and practices are in or affecting commerce, within the meaning of the Clayton Act, as amended, and the Federal Trade Commission Act, as amended (Complaint and Borg-Warner's Answer ¶ 10).

II. THE CHALLENGED ACQUISITION

A. *Agreement For Sale Of Assets*

24. On May 12, 1981, Echlin and Borg-Warner entered into an "Agreement for Sale of Assets," effective February 28, 1981, whereby Echlin would acquire all of the assets of Borg-Warner's automotive aftermarket divisions of the Transportation Equipment Group ("T.E.G."). In exchange, Borg-Warner received 4.5 million shares of Echlin's common stock, representing approximately 22% of Echlin's outstanding shares. The transaction was valued at about $62.4 million (Complaint and Echlin and Borg-Warner's Answers ¶ 11; CX's 500 at page "i", 239A through Z–66).

25. The Boards of Directors of Echlin and Borg-Warner gave their final approval to the transaction and Echlin's stockholders ratified the agreement on July 7, 1981 (Complaint and Echlin and Borg-Warner's Answers ¶ 11).

26. Subject to a hold separate agreement entered into by respondents and the Federal Trade Commission, the transaction was consummated on July 14, 1981 (Complaint and Echlin and Borg-Warner's Answers ¶ 11).

27. The "Agreement for Sale of Assets" between Echlin and Borg-Warner also contained certain additional agreements including: (1) a supply agreement wherein Borg-Warner agreed to continue to supply Echlin with various automotive parts and products which Borg-Warner's manufacturing divisions formerly supplied to the acquired divisions; (2) a trademark license agreement permitting Echlin to market products of the acquired divisions under the Borg-Warner name; and (3) an agreement to place a director designated by Borg-Warner on Echlin's Board (CX's 500 at 3, 239Z–67 through Z–87, Z–119, Z–204 through Z–208). **[9]**

28. During 1977, Borg-Warner's Aftermarket Task Force, an ad hoc group, compiled a study on Echlin focusing on the approaches Echlin had taken in marketing its products to the aftermarket. [***] (CX's 14A through Z–5, 39L *in camera*). It concluded that Echlin's success was "based primarily on quality, warranty, customer service, and price" (CX [***] 14N). [***] (CX 14C *in camera*).

29. Borg-Warner's interest in pursuing a transaction with Echlin was based on three factors: (1) Echlin was regarded as a "good investment"; (2) Echlin "specialized" in the automotive aftermarket business; and (3) the combination of the aftermarket businesses of Echlin and Borg-Warner would result in a "stronger replacement parts operation" (CX 240C).

30. A Borg-Warner official testified that the company agreed to the proposed transaction, which included supply and trademark agree-

ments, because Borg-Warner was obtaining a large equity position in Echlin as well as representation on Echlin's Board of Directors (Trauscht 3894–95).

B. *The Acquired Divisions*

31. Through the May 12, 1981 agreement, Echlin acquired all of Borg-Warner's so-called "Automotive Aftermarket Operations," comprising five Transportation Equipment Group ("T.E.G.") divisions. They included two manufacturing divisions (Ballwin/Washington and Ottawa Divisions) and three distribution divisions (the Automotive Parts Division "APD," APD International, and APD Borg-Warner (Canada Limited) (CX's 8A-C, 3Z–12, 239N through Z–66, 500 at 2, 25).

32. The Borg-Warner "automotive aftermarket operations" acquired by Echlin had 1980 sales of about [***] including carburetor kit sales of about [***] (CX's 3Z–12, 29X *in camera*).

33. The two divisions of Borg-Warner's automotive aftermarket operations involved in the production and sale of automotive carburetor kits in the United States were the Ballwin/Washington Division and APD. **[10]**

1. Ballwin/Washington Division (Ballwin/Washington)

34. In October 1966, Borg-Warner acquired Precision Automotive Components Company ("PACCO"), a company that manufactured carburetor parts and assembled automotive carburetor kits (CX 535E-F; Carlson 2525–27), and incorporated PACCO into Borg-Warner's Marvel-Schebler Division (Merz 2713). Sometime during the 1970's, Borg-Warner's two facilities involved in the manufacture of carburetor parts and the assembly of carburetor kits became known as the "Ballwin/Washington Division" (Merz 2718; Carlson 2572). The Ballwin/Washington Division ("Ballwin/Washington") includes Borg-Warner facilities located in Ballwin and Washington, Missouri (CX 500 at 26; Timberlake 3070–71).

35. [***] (Complaint and Borg-Warner's Answer ¶ 9; CX's 21J *in camera,* 27C *in camera,* 539Z–13 through Z–14). [***] (CX's 21J *in camera,* 24D *in camera,* 25D *in camera,* 26C *in camera,* 27C *in camera,* 39P *in camera*).

36. The Ballwin plant, located in Ballwin, Missouri, consists of two buildings, with a total of 100,500 square feet. One building is devoted to the assembly of carburetor kits and to the warehousing of all products produced at both the Ballwin and the Washington plants that are ready to be shipped. This building occupies approximately 78,500 square feet. The remaining space of 22,000 square feet consists of the office building where all the administrative functions for the

entire Ballwin/Washington Division are handled. Some of these functions include sales, finance, marketing and customer service (CX's 239Z–141, 500 at 28, 167E; Timberlake 3070–71).

37. The Washington facility, located about 35 miles from the Ballwin facility in Washington, Missouri, is devoted to the manufacture of carburetor parts, including those used in the assembly of carburetor kits. The facility occupies 69,300 square feet (Timberlake 3071; CX's 239Z–138, 167C, 500 at 28).

38. [***] (CX's 5C, 21J *in camera*, 24D *in camera*, 25D *in camera*, 26C *in camera*, 27C *in camera*, 39P *in camera*, 129Z–8, 167B, F, 169Z–8, Z–29, 500 at 26, 535R). [11]

39. [***] (CX's 162I *in camera*, 9Z–3).

40. [***] (CX 162K-M *in camera*). [***] (CX's 24E *in camera*, 25E *in camera*, 26D, G *in camera*, 27F *in camera*).

2. Automotive Parts Division (APD)

41. Prior to the transaction, APD was Borg-Warner's aftermarket distribution organization, headquartered in Franklin, Illinois (CX 500 at 25, 28). [***] (Complaint and Borg-Warner's Answer ¶ 9; CX's 5A, 21F *in camera*, 33D, L *in camera*, 34B, G-K, N *in camera*, 35H *in camera*, 39"O" *in camera*, 500 at 26, 535S).

42. [***] (CX's 21F *in camera*, 33D *in camera*, 34B *in camera*, 35B *in camera*). These facilities were leased and located in: (1) Pico Rivera, California; (2) Elkridge, Maryland; (3) Marietta, Georgia; (4) Mesquite, Texas; (5) Milwaukee, Oregon; (6) Philadelphia, Pennsylvania;; and (7) Norfolk, Virginia (CX's 5A, 239Z–135 through Z–138, 500 at 28).

43. [***] (CX's 21F *in camera*, 22E-F *in camera*, 33D, L, T *in camera*, 34N, V *in camera*, 35H, N *in camera*, 39"O" *in camera*).

44. [***] (CX's 21F *in camera*, 33P *in camera*, 34Q *in camera*). [12]

45. APD obtained its line of carburetor kits from the Ballwin/Washington Division (Merz 2715; McCurry 3837). APD was a "national account" of Ballwin/Washington.

46. Immediately following the consummation of the challenged transaction, Echlin renamed APD (now a subsidiary of Echlin) BWD, Inc. ("BWD") (Merz 2707, 2747; Martin 2788–89).

47. Prior to the challenged acquisition, Borg-Warner (through its Ballwin/Washington and APD divisions) was the nation's leading manufacturer and supplier of replacement carburetor parts of all makes to the replacement carburetor industry as well as the largest assembler and seller of carburetor kits in the United States (CX's 129Z–8, 163Z–9, 165V, 167B, 169Z–8, Z–29, 171A).

C. *Trademark License Agreement*

48. As part of the Agreement for Sale of Assets, Echlin obtained an exclusive license to use certain Borg-Warner trademarks in connection with the marketing and sale of various automotive replacement products, including carburetor kits, in the United States and Canada and a nonexclusive license for the rest of the world (CX 239Z–67 through Z–86, 500 at 3).

49. The trademark license gives Echlin the right to use the Borg-Warner name and other Borg-Warner trademarks on all products sold to the automotive aftermarket, including those sold through its BWD (formerly APD) and Ballwin/Washington (CX 239Z–67 through Z–68).

50. The trademark agreement between Borg-Warner and Echlin is effective for a term of 15 years and continues thereafter unless terminated by either party upon written notice five years prior to termination (CX's 239Z–79, 500 at 3).

51. The licensing of the Borg-Warner trademarks was an important feature of the transaction. [***] (CX 33D, H *in camera*). Echlin believed that the Borg-Warner trademark was "of importance to the financial condition and results of operations" of Borg-Warner's aftermarket operations and that the name was "identified with quality and dependability" and created "favorable consumer response" (CX 500 at 27).

52. The evidence shows that in the sale of carburetor kits today brand recognition or loyalty is no longer an important factor, primarily due to improved quality of all carburetor kits, and that as a practical matter neither WDs nor jobbers, much less installers, are brand conscious as far as carburetor kits are concerned (*e.g.*, Nelson 1622; Jursek 826; Tehansky 861; Carlson **[13]** 2569; Waters 3301; Brown 3373, 3382–83; Kotcher 3558; Foley 3790; Milford 3771).

D. *Supply Agreement*

53. As part of the Agreement for Sale of Assets, Echlin and Borg-Warner also entered into a supply agreement whereby Borg-Warner agreed to supply Echlin with automotive replacement products historically supplied to its aftermarket divisions sold to Echlin by the manufacturing divisions retained by Borg-Warner (CX's 239Z–204 through Z–208, 500 at 3). Under the terms of this supply agreement, sales of automotive replacement products will be at prices at least as favorable as those offered to other purchasers that compete with Echlin (CX's 239Z–205, 240"O", 500 at 3).

54. The supply agreement also provides that Echlin's BWD will continue as an aftermarket distributor in the United States for all

Borg-Warner manufactured automotive products (CX's 239Z–206, 500 at 3). Echlin agreed to purchase from Borg-Warner its requirements of those automotive replacement products which are manufactured by Borg-Warner divisions and presently sold (but not manufactured) by the divisions acquired by Echlin, provided that Borg-Warner prices remain competitive with those offered by other manufacturers and that Borg-Warner is able to meet Echlin's delivery requirements (CX's 239Z–206 through Z–207, 500 at 3).

55. The supply agreement between Borg-Warner and Echlin is effective for an initial term of 15 years and continues thereafter unless terminated by either party upon written notice five years prior to termination (CX's 239Z–208, 240P, 500 at 3).

56. The Agreement for Sale of Assets also provides for the election of one Borg-Warner representative to the Echlin Board as long as Borg-Warner owns at least 10% of Echlin's voting securities (CX's 500 at 3, 239Z–119, 240Q). Frank E. Pilling, a Vice President of Borg-Warner, became a director of Echlin in November 1981 (CX's 240Q, 500 at 3, 536D, 569Y).

E. *Hold Separate Agreement*

57. On July 7, 1981, respondents and the Federal Trade Commission signed a hold separate agreement pending resolution of this proceeding. The Commission agreed not to seek to enjoin consummation of the proposed transaction. The hold separate agreement also establishes certain requirements relating to Echlin's management of its own and the acquired assets involved in the assembly and sale of carburetor kits. The agreement provides that the Borg-Warner assets will be operated by Echlin as a viable and separate business entity and will continue to use [14] the Borg-Warner trade name and trademarks in the sale of automotive replacement products (Agreement, File No. 811–0094 (July 7, 1981)).

III. THE PRODUCT MARKET — CARBURETOR KITS

A. *Carburetor Kits — Their Evolution, Physical Characteristics And Uses*

58. Carburetor kits are used to tune-up or repair malfunctioning carburetors that do not require carburetor replacement.

59. An automotive carburetor is a mechanical apparatus designed to supply a specific mixture of vaporized gasoline and air to the combustion chamber of automotive engines and is a crucial component of the automotive fuel system. It usually consists of a core body and hard parts assemblies (such as needle and seat, pump plunger or diaphragm, economizer or power valve), fuel metering and airing de-

vices, gaskets and other small parts (clips, retainers, balls, plugs and springs).

60. The typical operation of a carburetor may be described as follows. *See generally,* RX's 164W-Z-3, 165"O"-T; Smith 3250–55, 3239–42. Gasoline enters the carburetor via the fuel inlet system consisting of a fuel bowl, inlet fitting, fuel inlet valve (needle and seat) and a float assembly. Gasoline flows through the seat until the level of fuel in the carburetor raises the float sufficiently to close off the needle and seat. As the level of fuel in the carburetor falls, the float is lowered, which separates the needle from the seat, thus allowing gasoline to flow into the carburetor. The fuel inlet valve (needle and seat) and the float must maintain the fuel level at the prescribed specification. The fuel then passes through a series of valves and jets, with its flow controlled by differences in air pressure, the opening and closing of mechanical valves, springs, diaphragms, pumps and check balls. During this process, both the fuel and the air pass through blend holes and the fuel-air mixture is ultimately drawn into the engine cylinder by a vacuum created by the movement of the piston. Added fuel for power operations is provided by various types of power valves actuated by a vacuum diaphragm and controlled by a power valve spring.

61. Carburetor "overhaul kits" (sometimes called "major repair kits") were introduced by Carter Carburetor Co., a carburetor parts manufacturer, during the late 1940's and became widely used during the early 1950's. Overhaul kits essentially contained all carburetor parts (excluding the core body) that may be needed for a complete overhaul of a particular carburetor model and included parts used in the fuel metering and airing **[15]** mechanisms, passage plugs and linkage for the outside of the carburetor (Thompson 2443; Carlson 2528–29).

62. "Consolidated kits" or carburetor "tune-up" kits were introduced in or about 1949 by Precision Automotive Components Company ("PACCO"), a carburetor components manufacturer and parts supplier to carburetor rebuilders and were designed to accommodate more than one carburetor model. Carburetor tune-up kits thus contained gaskets, float level gauge and other "high mortality rate" mechanical parts which were common to several carburetor models and an instruction sheet, but excluded metering parts and passage plugs. Thus tune-up kits contained less parts than did overhaul kits, were less expensive and more convenient to the automobile mechanic and gradually replaced overhaul kits during the 1950s (Thompson 2444, 2446; Carlson 2525–29; CX 169D).

63. The record shows that Berton Carlson of PACCO first conceived the idea of packaging carburetor parts most frequently needed for carburetor tune-ups into a kit form in or about 1949. Essentially,

Carlson (then in sales) and his partner and plant superintendent, Ernie Nieman, hired a draftsman, collected current carburetors, took measurements of component pieces to determine tolerances and introduced a line of about 20 tune-up kits (Carlson 2525–29).

64. After 1949, PACCO acquired carburetor component manufacturing facilities and, in addition to selling carburetor parts to carburetor rebuilders, gradually expanded its own line of carburetor kits and when PACCO was sold to Borg-Warner in 1966, its full carburetor kit line contained some 175 kit numbers (Carlson 2526, 2530).

65. Currently, carburetor kits generally include those carburetor parts that wear most rapidly or often ("high mortality rate parts")—needle and seat assemblies, pump plungers, and components with diaphragms—plus gaskets to replace those worn or damaged during carburetor disassembly and cleaning, and gauges for making adjustments and instruction sheets (CX's 129D, 163C). The "hard parts" in a kit, such as a needle and seat assembly, a pump plunger or pump diaphragm assembly and economizer or power valve, perform the same function they perform in a new carburetor (Thompson 297–300). Tomco kits contain a rotary disk fuel inlet valve instead of a needle and seat assembly to control the flow of fuel into the float bowl (Thompson 295, 297; *also see*, CX's 126C, 317Z–8, 436A).

66. The instruction sheet included in each carburetor kit provides illustrated, step-by-step instructions for performing a tune-up job using that kit. Detailed specifications for the adjustments required before and after the carburetor kit is installed are also included in each instruction sheet (CX's 169T-X, 431C, 129D; Sheehan 459–60). **[16]**

67. Normal wear on internal carburetor parts or deterioration of parts caused by gasoline additives may impair the proper functioning of a vehicle's carburetor resulting in poor engine performance and/or poor fuel efficiency. In such instances, a carburetor "tune-up" using the parts in a kit to replace the worn parts can return the carburetor to optimal performance (Martin 2794; Hawkins 1173; CX's 202F, 75B, 129D). Specific conditions which might indicate that a carburetor tune-up using a kit is necessary include hard starting, poor acceleration, rough idle, engine stalling, poor gas mileage, repeated flooding, or excessive gas leakage (CX's 328B, 202B-C, 122, 165Y).

68. A carburetor tune-up job using a carburetor kit involves the following steps:

(1) the carburetor is removed from the vehicle and disassembled;

(2) the core, or major body of the carburetor, and other re-usable (generally nonmoving) parts are cleaned by soaking in a cleaning solution and dried to insure that all internal passages are clear;

(3) the carburetor is reassembled and adjusted using the parts contained in the carburetor kit to replace worn parts and gaskets; and (4) the carburetor is reinstalled on the vehicle using the flange gasket (the major gasket included in a carburetor kit) to insure proper sealing between the base of the carburetor and the engine, and final adjustments are made (Schultz 3020–24; Smith 3168; CX 202C-E).

69. The time required for a carburetor tune-up job using a kit varies according to the complexity of the specific carburetor involved. Based on the six examples of carburetor repair jobs using a kit that Ballwin/Washington considered "typical" (*see* Secrest 1087–88), the labor time varies between two and three hours, with an average of 2.3 hours (CX 170J-O). The labor time used in the Ballwin/Washington sales presentations are derived from the *Mitchell Parts and Labor Estimating Guide*, a standard industry manual (*e.g.*, CS's 170I, 164H). An automotive mechanic testified that the labor times shown in this manual provided a ceiling for the amount of labor time he charged the vehicle owner. On occasion, he charged for less time than provided for by the standard manual (Milford 3776–77). The evidence shows that the time required for a carburetor tune-up varies from 1.5 to 3.5 hours depending on the nature and complexity of the **[17]** carburetor and the skill of the mechanic (Smith 3169; Milford 3376).

70. A proper carburetor tune-up and installation of a kit will "improve mileage, give steadier, smoother performance, and allow easier starting" by restoring the carburetor performance closer to its OE specifications (CX 129D).

71. Carburetor kits used on industrial and agricultural equipment and inboard marine engines are substantially different from those used on automobiles but are often included in suppliers' line of carburetor kits as a convenience to their customers, especially in coastal, industrial and agricultural areas where a demand for these specialized applications exists (Fife 622; Sheehan 468–69; Thompson 310; CX's 195–96, 198). [***] (CX's 465A *in camera*, 541R-S; Sheehan 468; Thompson 309–10). For example, sales of kits for these specialized applications represented less than half of 1% of Standard's total kit sales.

72. Various types of aircraft are also equipped with carburetors. However, kits for the repair of aircraft carburetors are distinct from automotive carburetor kits and have never been included in the line of automotive carburetor kits (Fife 623; Sheehan 470; Thompson 313; Waters 3314; CX 541Y).

73. Motorcycles are also equipped with carburetors but kits for motorcycle applications are not currently included in any line of automotive carburetor kits (Fife 623; Sheehan 470; Thompson 313–14;

Waters 3314). Borg-Warner's Ballwin/Washington Division offered motorcycle carburetor kits until 1976 but they were not included in Borg-Warner's line of automotive carburetor kits and were discontinued (CX 541W-X).

74. [***] (Thompson 313–14; Sheehan 469–70; Fife 622–23; CX's 471B, 468E *in camera*). Small engine carburetor kits are generally sold through specialized distributors and repair outlets. Although Borg-Warner and Echlin both offered small engine carburetor kits, those kits were sold under a different brand name and by a different corporate division than their respective automotive carburetor kit lines (CX's 534T-U, 238A, 538W-X, 541U-V).

75. During the 1980's, a throttle body fuel injection system ("TBI") was introduced in several vehicle models in order to deliver higher air-to-fuel ratio mixture necessary to insure higher fuel efficiency and lower air pollution. Simply put, a TBI system electronically controls the carburetion process by the use of a high pressure fuel pump, with a pressure regulator, [**18**] which forces the fuel through an injection nozzle. A TBI system is an electronically controlled fuel metering system, and as such, it does not include the mechanical parts found in a conventional carburetor, such as seat and needle, float, pump plunger or piston, accelerator pump and economizer valve. Thus, a TBI is substantially different physically from a carburetor, although they both perform the carburetion function in a vehicle's fuel system (Fife 699–700; Smith 3256–59).

76. In response to the introduction of the TBI system on a number of late model automobiles, Borg-Warner introduced TBI repair kits and included them in its July 1980 Supplement to Automotive and Carburetor Tune-Up Kit Catalog (CX 40 at 12; *see* CX's 189A, F, 129Z–3 through Z–4, 537Z–27). TBI repair kits are or will be offered by most major carburetor kit suppliers as a demand therefor materializes (Fife 698–700; Smith 3284; Thompson 381; Jursek 797–98; CX's 611A, 189A, F).

77. The evidence indicates the conventional carburetor and the TBI will both be used in new automobiles for several years, that carburetors will continue to play the dominant role through the 1980's until the TBI is cost-refined to be competitive or give superior mileage beyond their present capabilities, and that this evolution will happen when the demand for conventional carburetors will diminish (Fife 698–99; Smith 3281–83; CX's 129Z–3 through Z–4, 163Z–4).

B. *The Production Of Carburetor Kits*

78. The carburetor kit production process is essentially an assembly operation and does not encompass the fabrication or manufacture of carburetor components that are included in carburetor kits.

79. The physical carburetor kit assembly operation is a simple and largely manual process and is typically performed on short, moving packaging lines or at rotating tables, generally by semi-skilled female employees. When a line is used, it is first "set up" with bins or boxes each containing different parts that had been pulled from inventory using the "bill of materials" (F. 138, *infra*) for the specific kit being assembled. Many assembly operation begins with a "Kliklok" machine which forms a cardboard tray to hold the different parts that go into the kit. As the trays move down the conveyer belt, workers place parts (or plastic bags containing several small parts) out of the bins into each tray. At the end of the line, the trays are wrapped with plastic, heat-sealed and placed into shelf cartons.

80. The number of lines operated varies from one to four. [***] (Hawkins 1179; Thompson 337–38, 2499; Fife 647; Sheehan 574; CX's 533K, 542Z). **[19]**

81. When only a small quantity of a given kit is needed, the assembly operation is performed at a rotating table with a large lazy-Susan-like tray at the center bearing different parts. Workers sit around the table and place the needed parts into a bag or tray (Timberlake 3116, 3136).

82. In mid-October 1983, the administrative law judge had occasion to view both the line and table type carburetor kit assembly operations of Tomco at its St. Louis plant and was impressed by the simplicity of the process which appeared neither elaborate nor complex (*see* RX's 398–404 (photographs showing a packaging line at Echlin's Ballwin/Washington plant)).

C. *Substitute Products And Price Sensitivity — Replacement Carburetors And Carburetor Kit Components*

83. The parties agree that new and rebuilt replacement carburetors are functional substitutes of carburetor kits in the sense that any carburetor malfunction can be resolved by replacing the carburetor rather than by repairing it. However, the two product groups are not true substitutes for each other to the extent that a carburetor failure or malfunction which is due to structural damages to the carburetor casing or core, or to worn linkage or throttle shaft, cannot be "repaired" by installing a kit and requires replacement of the entire carburetor (Thompson 2494–95; Martin 2795; Nelson 1400–04; CX's 328B, 202G; F. 88–91, *infra*).

84. New and rebuilt replacement carburetors are substantially more expensive than carburetor kits. Common sense and daily experience show that automobile mechanics and vehicle owners will not use replacement carburetors for carburetor malfunctions which can be resolved by a carburetor tune-up using a kit. In this sense, replace-

ment carburetors do not offer an economically reasonable alternative to carburetor kits and are not practical substitutes for carburetor kits. This holds true when the total cost to the consumer, including labor cost, is considered (F. 92–98, *infra*).

85. The record shows that replacement carburetors and carburetor kits are intended and employed for different uses, that there is no price sensitivity between the two product groups, and that replacement carburetors do not offer an economically reasonable alternative to carburetor kits. Therefore, replacement carburetors are not close-enough substitutes to be included in the same market with carburetor kits.

86. The parties also agree that individually packaged carburetor parts which are generally included in carburetor kits [**20**] today can be used interchangeably with kits. However, the record is clear that the availability of each of the numerous kit parts, individually packaged or in bulk form, to the automobile mechanic or vehicle owner, is rather limited and that, in any event, the sales of such individual parts are *de minimis* (F. 108–09, *infra*). This comports with reason and common sense. The raison d'etre of kits is economy and convenience. Thus, individual carburetor parts included in carburetor kits, either separately or collectively, are not practical substitutes for carburetor kits. Therefore, they are not close-enough substitutes to be included in the same product market with carburetor kits.

87. However, the record also shows that replacement carburetors, carburetor kits and kit parts are competitive products in a broad sense and this important fact will be duly taken into account in evaluating the competitive effects of the challenged acquisition.

88. A carburetor tune-up using a carburetor kit is appropriate when cleaning and installing the parts included in a kit can return a carburetor to optimal performance. In contrast, when wear or damage is so extensive that it cannot be repaired by using the parts included in a kit, it is necessary to replace the carburetor with a new or rebuilt carburetor. Conditions which require replacement include a cracked or warped carburetor casing, a broken core, worn linkage or a worn throttle shaft (Martin 2794; Thompson 2494–95; Nelson 1400–04; CX's 328B, 202G).

89. Documents generated by both respondents reflect their clear understanding of the different uses for which carburetor kits and replacement carburetors are intended. For example, counter literature prepared by Borg-Warner to explain the use of carburetor kits to vehicle owners states as follows: "If your mechanic has decided not to overhaul your carburetor, it is probably because it was missing parts or crash-damaged—in which case the necessary parts would not be in a standard tune-up kit or repair of the carburetor is inadvisable.

In this case, we advise you follow your mechanic's recommendation for a new or rebuilt carburetor—because he is in the best position to judge the quality of rebuilt carbs available in your area" (Nelson 1403–04; CX 202G). A similar document prepared by Echlin explains the different purposes and uses for carburetor kits and replacement carburetors: "Carburetors should be replaced whenever there is wear or damage to parts that will not be replaced in overhauling" (*i.e.*, repair with a kit) (Nelson 1400–02; CX 328B).

90. Mr. Milford, an automobile mechanic called as a witness by respondents, testified that he always used a carburetor kit to perform a carburetor repair so long as repair with the kit was sufficient to remedy the problem and the carburetor kit was available, which it virtually always was (Milford 3777). As a general rule, Mr. Milford would replace the carburetor when repair with a kit was not possible (Milford 3777–78). **[21]**

91. While either a new or a rebuilt replacement carburetor may be used when repair with a kit is impossible, some aftermarket suppliers and mechanics prefer the new to the rebuilt because of quality considerations (Milford 3780–82; Foley 3801–02). Echlin also discouraged the use of rebuilt carburetors because of their poor quality (CX 328A).

92. A replacement carburetor can always be used when repair with a carburetor kit would be sufficient. However, for functional substitutes to be included in the same product market, it is essential that they be economically reasonable alternatives (Glassman 4370–71; Nelson 1399–400). The large price differentials prevailing at every level of distribution, including prices charged the ultimate consumer (the vehicle owner), between replacement of the carburetor and repair using a kit suggest that these products are not economically reasonable alternatives. In letters written to its carburetor kit customers, Ballwin/Washington showed illustrations of the large price differentials involved in the use of a kit as compared to replacement of the entire carburetor. In 1976, the vehicle owner's total cost, including labor, for replacement of a "typical" carburetor was about $110 if a rebuilt carburetor was used, and about $170 if a new replacement carburetor was installed. Barring a structural damage or worn linkage or shaft, that carburetor could be "tuned-up" using a kit for only $60 (CX 128C). In 1980, these costs had increased to about $154, $206 and $65, respectively (CX 128C). New replacement carburetors for larger and more complicated engines cost as much as $400 to $600 by early 1982 (CX 180A). As a Ballwin/Washington official stated: "Consumers with carburetor malfunction cannot and will not choose new carburetors as a solution to their problems" (CX 180A).

93. Sales presentations prepared by Ballwin/Washington for its national account (private label) kit customers also include cost com-

parisons between using a replacement carburetor and a kit (*see* CX's 129E-M, 163D-L, 164I-N, 165D-K, 166J-Q, 168H-O, 170H-O). In preparing these sales presentations, Ballwin/Washington selected typical, popular applications for various types of carburetors (Secrest 1087–88). An analysis of the costs to the vehicle owner reflected in these documents reveals that the cost of repair with a carburetor kit is significantly lower than replacement of the carburetor (*see, e.g.*, Nelson 1406–07; CX's 165D-K, 170H-O, 128C, 129Z–12). For example, in a 1981 sales presentation, Ballwin/Washington compared the costs of repair with a kit versus replacement of the carburetor for six common applications (CX 164I-N). While the total cost to the customer for repair with a carburetor kit averaged $91.57, the customer's cost to have the carburetor replaced averaged $162.14 for replacement with a rebuilt carburetor, and $198.77 with a new replacement carburetor (CX 164I-N). The average list price that the customer would be charged for the carburetor kit itself was $19.12 (CX 164I-N). For these applications, the price of the **[22]** carburetor kit would have to increase between *280* and *700%* before the cost of repair to the consumer would equal that of replacement with a rebuilt carburetor (Nelson 1420). The comparison to new replacement carburetors is more striking: the price of the carburetor kit would have to increase *415* to *1,000%* before the repair bill to the consumer would equal replacement with a new carburetor (Nelson 1421).

94. Mr. Milford provided additional examples from his business experience of the price differential to his customer (the vehicle owner) between repair with a carburetor kit and replacement of the carburetor. For a standard carburetor model that has been available for many years, replacement of the carburetor would cost the vehicle owner between $156 and $176. Repair with a carburetor kit for the same application would cost $60–$65 (Milford 3783–84). The price differential on newer vehicles is much larger. On certain GM Citations, for example, replacement of the carburetor would cost the vehicle owner between $620 and $760, while tuning-up the carburetor with the use of a kit would cost the consumer $130–$140 (Milford 3778–79).

95. The disparity between the profit potential to the mechanic of repair versus replacement is also large (Brown 3409–10; Tehansky 862; CX's 121, 129Z–12). For example, a 1981 sales presentation by Ballwin-Washington reveals that an installer retained an average of 88.2*%* of each repair dollar when a carburetor kit was used as compared to 37.9*%* or 39.8*%*, respectively, for replacement with a new or rebuilt carburetor (CX 168H-I; *see also*, CX's 164H, 170H-I, 166J-K, 128C, G).

96. In early 1984, the average price a mechanic paid a jobber for a typical carburetor kit amounted to approximately $20.00 (Milford

3779–80). Even a 10% increase in that price would not have any effect on the mechanic's decision whether to use a carburetor kit or replace the carburetor since the price differential between these products would remain large (Milford 3780).

97. Mr. Carlson, a witness called by respondents, whose company sells private label carburetor kits produced by Ballwin/Washington, agreed that a 5% increase in the prices his company charged for carburetor kits "would not affect our business in any way" and would not cause a loss in sales due to any shift in demand towards replacement carburetors (Carlson 2645–46).

98. Carburetor repair using a kit has always been significantly less expensive than replacement of the carburetor (Carlson 2639; CX 537Z–68). The price differential between repair using a kit and replacement of the carburetor has widened in recent years, making replacement in lieu of repair even more uneconomical to the vehicle owner (Merz 2776, 2780; Thompson 419; Hawkins 1200; CX 128C). **[23]**

99. Thus, the record evidence shows that kit assemblers can raise kit prices by 5% without causing a substantial shift towards replacement carburetor and suggests that these two products do not belong in the same product market. *See U.S. Department of Justice Merger Guidelines* Section 2.11 (June 14, 1984); *Statement of Federal Trade Commission Concerning Horizontal Mergers* at 12 (June 14, 1982).

100. Respondents argue that an increase in the price of replacement carburetors has caused an increase in the demand for kits and that, therefore, the opposite must be true (*see* RPFs 107–18). However, respondents' evidence linking the increase in replacement carburetor prices to an increased demand for carburetor kits is unpersuasive.

101. Respondents' own documents list some half a dozen factors that might be responsible for any increase in the demand for carburetor kits (*e.g.*, CX's 164D, 166F, 168D, 169E; *see also* Fife 695–96). It would be difficult, if not impossible, to determine the significance of any one particular factor. Moreover, the Hunter Service Job Analysis ("SJA") statistics relied on by respondents' experts in asserting that increased carburetor prices have resulted in an increased demand for carburetor kits (RPFs 113–16) arguably demonstrate just the opposite.

102. Between 1978 and 1981, during the period when testimony by respondents' own employees and evidence from respondents' documents show that the prices of replacement carburetors increased the most (*see, e.g.*, Merz 2776; CX's 537Z–66 through Z–68, 128C, 168D; *compare* CX 129F-M, which contains 1979 replacement carburetor prices, to CX 168I-O, which contains August 1981 replacement carburetor prices), the SJA statistics show a *decrease* in the demand for carburetor kits as compared to the demand for replacement carburet-

ors (Willig 4922-23; CX 567). Furthermore, the data base for RXs 407-08 relied on by respondents is so mixed that their reliability for the proposition that there is a statistically significant relationship between increased prices for replacement carburetors and increased demands for kits is questionable (*see* Glassman 4397-472; Willig 4917-26).

103. Although there is evidence which suggests that extremely large increases in the prices of replacement carburetors (*see, e.g.*, Hawkins 1200; CX's 128C, 180A) caused some increase in the demand for carburetor kits, this evidence would not support the proposition that a 5% increase in the prices of carburetor kits, which would amount to an increase of approximately $1.00 (*see* F. 93-94), would bring about a significant increase in the demand for replacement carburetors. Indeed, the weight of record evidence is to the contrary.

104. On the other hand, the record is clear that the prices of carburetor kits are not raised or lowered in response to a **[24]** movement in the prices of replacement carburetors (Sheehan 559-60; Hawkins 1198-99; Jursek 787; Thompson 378; Fife 675-76; Carlson 2608-09; Baumann 1028-29). Conversely, movements in the prices of carburetor kits have no effect on the prices of replacement carburetors (Cardone 3624; Sheehan 560; Hawkins 1199; Baumann 1029).

105. The primary factors considered by carburetor kit assemblers in establishing the prices of carburetor kits are: (1) cost; (2) desired profit margin; and (3) competitors' prices for comparable kits (Carlson 2581; Eaton 2942-43; Fife 674-75; Hawkins 1193; Jursek 786; Secrest 1112; Smith 3230; Thompson 377; CX's 533Q, 535Z-39 through Z-40, 539Z-31, 80). Also, respondents analyzed and compared prices and return on investment only with reference to other lines of carburetor kits (Carlson 2582; Secrest 1105; Sheehan 557; Timberlake 3093-94; CX's 80, 107-08, 113, 129Z, 209A, 211, 570C, 541Z-39). Testimony relied on by respondents in RPFs 130-40 primarily reflects kit suppliers' recognition that carburetor kits and replacement carburetors are competitive products and, to the extent it can be said to suggest that replacement carburetor prices are among the determining factors for kit prices, it is contrary to the weight of record evidence and, in any event, is insufficient to establish price sensitivity between kits and replacement carburetors.

106. Price sensitivity is determined by the presence or absence of price changes in one product in response to movements in the prices of another product. *See, e.g., Avnet, Inc. v. FTC*, 511 F.2d 70, 77 (7th Cir.), *cert. denied*, 423 U.S. 833 (1975). While carburetor kit assemblers may be generally aware of the prices of replacement carburetors, the evidence clearly shows that there is no price sensitivity between carburetor kits and replacement carburetors. Prices of car-

buretor kits are not raised or lowered in response to a movement in the prices of replacement carburetors or vice-versa.

107. There is also some evidence tending to show that replacement carburetors are viewed as a distinct product market. Neither Holley nor Carter considered their respective sales of replacement carburetors as in any way affecting their sales of carburetor kits (Jursek 785; Sheehan 559). Similarly, [***] (Thompson 379). [***] (Nelson 1379–82; CX's 24C *in camera*, 25C *in camera*, 140C, 162Z–26 *in camera*, 169Z–17 through Z–18, 20Z–2 through Z–3, Z–18 through Z–19 *in camera*, 136A, 331A).

108. The record evidence regarding the availability of carburetor parts generally included in kits as individually packaged parts is somewhat mixed. It appears that Echlin offered in late 1970's a number of kit components, including some diaphragms, needle and seat assemblers, power valves, pump **[25]** plungers and some small parts, to NAPA (CX's 249, 250 at 139–40, 145, 148, 254 at 31–35). There are other kit suppliers which offer some individual kit components for sale (Thompson 269, 2471; Martin 2804–05; Timberlake 3138). Some kit suppliers which once offered kit components for sale no longer do so (Sheehan 495, 516–18; Fife 616–17). After the challenged acquisition, both Ballwin/Washington and APD began to sell individual parts (Timberlake 3125–27, 3138; Eaton 2981–82; Martin 2804–05). The record also shows service guides containing instructions for the use of parts for various makes of carburetors are available (RX's 162–65). The record as a whole is clear that at the time of the challenged acquisition, the availability of each of the parts included in kits, either individually or together, was rather limited (*see* CPF 188–89).

109. In any event, there is no dispute about the fact that sales of carburetor parts generally included in kits as individually packaged parts are *de minimis* (Glassman 4491; Fife 672–73; Thompson 369; Castagna 3751–52; CX's 148, 570B). This fact underscores the raison d'etre of kits, namely, economy and convenience. Since a kit includes those parts of a carburetor most subject to wear or deteriorate, when one of the parts needs to be replaced, it is likely that the other parts included in a kit also need to be replaced. And the cost of handling, inventorying and billing the thousands of different parts included in a line of kits is prohibitive at the WD, jobber and installer levels of aftermarket distribution (Martin 2793; Fife 673; Insalaco 948–49; Eaton 2982–83; Sheehan 495, 516–18, Castagna 3752; Nelson 1391–94).

110. The record is also clear that carburetor parts and emission control parts that are not included in kits, such as floats, dashpots and choke pull-offs, are not functional substitutes for kits and do not

belong in the same product market with carburetor kits (Fife 674; Sheehan 523–24; Insalaco 949–50; Glassman 4396; CX 106B).

111. From the foregoing findings, it is determined that a preponderance of credible evidence in the record as a whole supports complaint counsel's position that the assembly and sale of carburetor kits constitutes an appropriate product market for the purposes of this case.

IV. THE GEOGRAPHIC MARKET

112. The parties agree that the relevant geographic market in which to assess the effect of the challenged acquisition is the United States as a whole (Complaint and Answer ¶ 12). **[26]**

V. THE NATURE OF COMPETITION IN THE CARBURETOR KIT MARKET

A. *Sourcing*

113. The term "sourcing" in the automotive aftermarket means purchasing various components or other sundry parts used in producing or assembling a finished product, including replacement carburetors and carburetor kits. The term "make-or-buy decision" is related to "sourcing" and means a decision either to make or to buy from an outside supplier a needed component part.

114. A make-or-buy decision is based on such factors as the comparative costs of manufacturing versus purchasing, the anticipated volume of usage of a given part, in-house manufacturing capabilities, and the availability of outside suppliers (Schultz 3045; Fife 643; Sheehan 494; Thompson 321; CX's 331A, 537Z–46, Z–49). An initial "buy" decision regarding a part may later be changed to "make" decision if there is an increase in usage of the part beyond the original projection (Fife 643–44; CX 533Z).

115. If a buy decision is made, suppliers must be located. It is generally preferable to have two sources for a part or component of a part to assure better quality, price and availability (Schultz 3043; Timberlake 3081–82; CX's 538Z–66, 539Z–9). The criteria in selecting a parts or component supplier include price, quality and reliability (Bush 2908–09, 2868; Thompson 328–32; CX's 537Z–38, 539Z–8). In soliciting bids, the assembler sometimes provides design and material specifications to potential suppliers (Bush 2868, 2909–10, 2912; Timberlake 3082). [***] (Bush 2909; Thompson 403–04; Fife 646; CX's 544V–Y *in camera*, 457B). In some cases, parts are rejected because the configuration or material is unacceptable (CX's 378B–E, 492A).

116. [***] (Thompson 331; CX's 497A–B, 366–67, 377B–C, 372B, 382A, 544Z–63 through Z–96 *in camera*, 56A–P, 201). Assemblers may not be able to take full advantage of available volume discounts on the parts they buy because of the low level of sales of a given kit, the costs

of increased parts inventory, and the required inventory space (Thompson 334; Fife 646–47).

117. Whether made or bought, all parts undergo visual or other tests on a sampling basis before they are used in kit assembly (Thompson 333, 405–07; Sheehan 495; Timberlake 3083–84; CX's 539Z–20 through Z–21, 384B–X, 412A–Q, 408A–K, 410A–F, 167D). **[27]**

118. Most carburetor kit assemblers purchase some kits from other kit assemblers. Kits most often purchased are generally those needed to fill out a line or those with lower demand and include kits for foreign car applications, tractor or industrial applications (Thompson 335–36; Sheehan 473; CX 538Z–42 through Z–43). Borg-Warner did not purchase any carburetor kits for resale (CX 16). Although self-sufficiency is desired by all kit assemblers (Jursek 729; Sheehan 527–28), the number and availability of new parts required for a kit are often important factors in making a buy-or-assemble decision (Fife 626; Jursek 728).

119. In-house production of parts has important advantages over purchases. Most importantly, necessary parts may be unavailable or in short supply from outside suppliers (Fife 644, 669; Nelson 1561; *see* Jursek 728–29). For example, Echlin's preacquisition decision to begin manufacturing certain pump plungers and pump diaphragms for inclusion in its carburetor kit was necessitated by the fact that no supplier would manufacture these parts with the type of material Echlin specified (CX 331A–B; *also see* CX 456). [***] (Nelson 1562–65; Jursek 729; CX's 455, 26I *in camera; see* CX's 33T *in camera,* 232 at 3, 233 at 4, 20E *in camera*). In a pre-acquisition letter to Sherman, one of its leading parts suppliers, Echlin exhibited a keen awareness of these advantages. After stating that it was willing to continue to purchase parts from Sherman as long as Sherman was supplying top quality products, meeting its delivery performance and pricing the parts in a way that enabled Echlin to meet its profit goals, Echlin went on to state: "If we deviate from this sound business principle, then Echlin would have to tool products that it would prefer to buy from Sherman" (CX 455; *see* Nelson 1563).

120. That dependence on outside suppliers for carburetor kit components can create a serious problem for an assembler was driven home to Echlin in 1979 when, because of problems with its parts suppliers, it faced a serious "back order" problem with a number of carburetor kits and feared the loss of its NAPA carburetor kit business (Echlin's premier account) to a competitor (CX 456).

121. The evidence shows that all of the leading assembler-sellers of carburetor kits, with the notable exception of Echlin, were integrated backward to a significant degree and fabricate ("make"), either in-house or through contracts, many of the more important components

used in carburetor kit assembly (Borg-Warner, F. 35–37, *supra;* Standard, F. 178, *infra;* Echlin, F. 3, *supra;* GM, F. 182, *infra;* ACF, F. 184, *infra;* Tomco, F. 186, *infra;* Holley, F. 188, *infra*). The evidence also shows that carburetor parts production of GM and Carter were limited to parts with application on carburetors of their own make and that Borg-Warner and Sherman Carburetor Company were the two primary **[28]** sources of carburetor and kit components for the kit assemblers. However, the record shows that there are a large number of suppliers for the various components that make up carburetor kits (*e.g.*, Bush 2861–921; Thompson 326–28, 2454–55; Sherman 585; Jursek 732–35, 811–12, 823–26; Insalaco 910–14, 983–84; Lehman 5046; Schultz 3040–41, 3043; Timberlake 3081, 3096; Smith 3179–80; RX 276; CX 535).

122. [***] (CX 39P *in camera*).

123. In sales presentations to its carburetor kit "national accounts" (private brand sellers) customers, Borg-Warner emphasized its carburetor components manufacturing capabilities as an important element and touted itself as a "basic manufacturer of carburetor components of all makes" (*e.g.*, CX's 129Z–8, 169Z–29, 163Z–9, 190A; *also see*, CX's 145A, 127E).

124. Prior to the challenged acquisition, Echlin was the only leading assembler of carburetor kits which did not make any carburetor parts it sold or used in kit assembly, except on an experimental basis during 1980 and 1981 (Schultz 3057; Timberlake 3127; Smith 3178–79, 3233–35; CX 235B). The importance of carburetor parts or carburetor kit components manufacturing capabilities (via backward integration) was driven home to Echlin more than once through problems with some parts suppliers (*see* F. 120, *supra*).

125. By reason of the July 14, 1981 consummation of its acquisition of Borg-Warner aftermarket divisions (including Ballwin/Washington), Echlin has become a leading supplier of carburetor parts of all makes and carburetor kits as well as the largest assembler of carburetor kits in the United States.

B. *The Development And Maintenance Of Carburetor Kit Lines — Consolidation And Full Line*

126. The automotive repair industry is a service industry and time is an important factor in the success of an automotive service station or mechanic. Therefore, it is essential throughout the channels of distribution in the aftermarket that replacement parts be readily available to service the vast majority of vehicles on the road (Fife 622, 625; CX 233 at 8). [***] (CX 33S *in camera*). **[29]**

127. In 1981, there were well over 15,000 distinct automotive carburetor models. In order to meet the potentially diverse demand for

specific carburetor tune-up applications, Borg-Warner's Ballwin/Washington Division offered a line of 429 carburetor kits which could service 15,099 different carburetor models; the Carter Automotive Division of ACF Industries, Inc. ("Carter") offered a line of 526 kits to service 12,000 carburetor models; Echlin offered 623 kits to service 13,098 carburetors; General Motors Corporation ("GM") (under the AC-Delco name) offered 533 kits for 12,923 carburetors; and Standard Motor Products, Inc. ("Standard") (under the Hygrade name) offered 462 kits for 11,535 carburetors (CX's 168P, 170P).

128. Because of the wholesale (warehouse) distributors' demand for broad coverage, a kit supplier must be able to offer a full line of carburetor kits in order to compete effectively (Fife 625; Sheehan 471–72; Hawkins 1177–78; Tehansky 853; Eaton 2978; Thompson 314; Willis 3450; Lingle 3516–17, 3527; CX's 541Z–23, 129Z–12, 546B). A supplier offering a "short-line," comprised of only the most popular kits cannot compete effectively against a full-line seller (Eaton 2978; Sheehan 471, 582; CX's 535Z–47, 541Z–23, 546B). For this reason, most kit assemblers, with the exception of Borg-Warner, purchase various amounts of kits (mostly from Borg-Warner) in order to fill out their lines (*see* F. 150–51, 176 *infra*). The coverage or breadth of carburetor applications included in each supplier's kit line is stressed in trade journal advertising and other sales material and is an important aspect of competition among suppliers (Jursek 780; CX's 120–21, 123C, 125 at 8, 126B, 138B, 129N, 236). For example, Borg-Warner advertised that its kit line provided the "[m]ost recent and broadest vehicle application coverage available" (CX's 120, 169I).

129. Tune-up kits used to repair automobile and light truck carburetors account for the vast majority of kits being offered today (Nelson 1346; Fife 621–22).

130. A supplier of carburetor kits must initially determine which kits to include in order to provide the broad coverage required in the aftermarket. Since new carburetors are introduced each year, kit assemblers must review their kit line annually (Fife 638–40; Hawkins 1181; CX 537Z–40 through Z–41). The number of new kits that must be added each year has increased dramatically in recent years in response to the proliferation of new carburetor models and the increased demand for carburetor kits with application on foreign vehicles (Hawkins 1180–81; Thompson 301–03; Fife 624; Sheehan 485; Nelson 1557–59). For example, in 1977, Standard's kit line provided coverage for 6,540 different carburetors whereas in 1981, Standard's kit line covered 11,535 distinct carburetors (*Compare* CX 165P with CX 166R; Nelson 1558–59). A certain number of kits are also dropped from the line annually when decreased demand, consolidation with other kits or replacement by a kit containing **[30]** slightly different or

improved parts occurs (Fife 640; Hawkins 1184; Thompson 320; Schultz 3036; Sheehan 458–59).

131. The annual review of the line generally entails an analysis of: (1) all new carburetor models for the current year; (2) the potential demand for a carburetor kit for a given application, which includes consideration of projections of new vehicle sales; and (3) the applications included in competitive kit lines (Fife 626–27; Sheehan 474–75; Smith 3174; CX 539Z). [***] (Thompson 2453; Rivet 2824–26; Schultz 3035; Smith 3176; CX's 570C, 215B, 162Z–27 through Z–28 *in camera*, 115B, 538Z–48 through Z–50).

132. The degree of consolidation is another way in which the various kit lines may be promoted (*e.g.*, CX's 84A, 546B). Consolidation is accomplished by including in a single kit more parts than are needed for the repair of one carburetor so that the kit can be used to repair a number of similar models of carburetors. By consolidation, the kit assembler can reduce the number of different kits included in its line without reducing the coverage offered (Hawkins 1181; Thompson 302; CX's 537U–V, 538Z–4, 539Z–2, 105C, 129Z–11). On the other hand, kit assemblers must avoid over-consolidation which leads to unacceptably high costs per kit and requires the kit user to discard too many unused parts (Rivet 2833–34; Fife 636–38; Jursek 737; CX 216C–F).

133. Kit assemblers review annually the consolidation of the kits which they sell (Rivet 2833; Hawkins 1182; Sheehan 488; Thompson 319, 2479–80; CX's 533S, 539Z–2). The focus of this review is a comparison by the assembler of the consolidation of its kit line with that of its competitors (CX 541Z–12 through Z–13).

134. The degree of consolidation of carburetor kit lines is a major selling tool which is emphasized in advertising, promotional activities and sales calls (Tehansky 850–51; Secrest 1092–94; Fife 637; CX's 69, 115A, 116A, 127G). For example, Ballwin/Washington includes, in its national account sales presentations, detailed consolidation comparisons of its kit line with that of other kit suppliers, including an analysis of inventory cost, inventory turnover and return on investment (CX's 163N through Z–1; 168Q through Z–2, 170Q through Z–2, 129 "O"–Z; *see* Secrest 1089–94).

135. As an integral part of the decision as to which kits to include in its line, an assembler also must decide which specific parts to include in each kit (CX 539W–X; *see also*, Thompson 316–17, 397–98; CX's 537Z–40 through Z–41, 538I). **[31]**

136. Changes in the material used in existing model carburetors may require a review and a determination of the parts to include in existing kits (Sheehan 458–59, 476–77; Hawkins 1185). Carburetor kit assemblers also emphasize the development of new materials and designs for the carburetor parts included in their kits as a way to gain

market advantage (CX's 128D, 162Z–30, 98P, S, T, X, 99U, X, 101B, C, 105D, F, N, Q, S, 129Z–5 through Z–6, 187G–H). In addition, the quality of those parts included in kits is emphasized in promotional activities (CX's 98–105, 426 at 86, 431B).

137. The instruction sheet contained in every carburetor kit is prepared from service manuals available from vehicle and carburetor manufacturers. The leading kit assemblers, however, design some of their instruction sheets and Borg-Warner and Carter obtained copyrights for their instruction sheets (Thompson 339; Sheehan 459–63, 579–80; Fife 648; Hawkins 1188; Rivet 2834–35; CX's 126C, 169T, 218A, 434, 431C, 537Z–51 through Z–53).

138. [***] (Rivet 2851; CX's 402–03, 220, 421A–K *in camera*). These bills of materials are considered proprietary by the kit assemblers (Sheehan 481–83; CX 220).

139. The kit coverage offered for carburetors on domestic vehicles is generally broader than that for import vehicle carburetors (*i.e.*, 95 to 100% coverage for domestic vehicles and 75 to 95% coverage for foreign applications) (Fife 624–25; Jursek 716–17; Sheehan 463–64; CX's 126B, 167B, 538Z–9 through Z–10). Carburetor kits are being produced for carburetors first installed as original equipment 20 to 30 years ago as well as for more recent carburetor models (Hawkins 1177; Jursek 716–17; Thompson 308; CX 538Z–9 through Z–10). Although kits can be obtained for the current model year's carburetors through vehicle dealers (Sheehan 464–65; Baumann 1012–13; Hawkins 1180; Thompson 398), there is a "lag time" of about 12 months between the introduction of a new carburetor on a new model vehicle and inclusion of a corresponding kit in a kit supplier's line (Merz 2723–24; Rivet 2824; CX's 541Z, 538Z–10).

140. [***] (Fife 640–41; CX's 30U *in camera*, 24D *in camera*). [***] (CX 169I). [***] (CX 21J *in camera; see* CX's 24D *in camera*, 25D *in camera*, 26C *in camera*). [***] **[32]** (CX's 24D *in camera*, 25D *in camera*, 26C *in camera*).

C. *Marketing And Distribution Of Carburetor Kits*

141. [***] (Nelson 1424–26; CX 15N *in camera*). The same holds with respect to private brand carburetor kits sold by the so-called "resellers," which do not package kits they sell.

142. The vast majority of carburetor kits are sold through the traditional warehouse dealer/jobber channel (Fife 655; Jursek 778; Sheehan 537–39; CX's 570A, 535Z–17 through Z–18, 26G). [***] (Fife 655; Tehansky 841, Bull 3648–50; CX 14Z–3 through Z–4 *in camera*, 404D).

143. There are [***] to [***] WDs throughout the United States which warehouse numerous aftermarket product lines in order to assure quick delivery of specific replacement parts ordered by their

jobber customers (Tehansky 836; Merz 2785; Bull 3693; Castagna 3754–55; CX's 33L, V *in camera*, 34N *in camera*). They may carry in stock [***] to [***] different replacement parts, including a full line of [***] to [***] carburetor kits (Bull 3642; Brown 3369; Waters 3314; Kotcher 3571; Castagna 3759; CX 15J, X *in camera*).

144. About [***] jobbers stock automotive replacement parts for sale to over [***] installers (CX 33L *in camera*). Jobbers generally stock 95 to 120 different carburetor kits and rely on their WDs for other kits not in stock (Bull 3654, 3692–93). Jobbers expect the WDs to carry a full line of carburetor kits at all times (Foley 3799) and try to give immediate delivery of parts to installers since installers do not generally inventory replacement parts (Tehansky 842–43).

145. Many WDs and jobbers are members of program [***] distribution groups. (CX 33Q *in camera* [***].) Program distribution groups may be "controlled" by common ownership of WD and jobber members (such as NAPA, APS, Republic and ITT) or "noncontrolled" (such as Bumper-To-Bumper, Carquest and Pronto) (Brown 3383–84, 3407–08; Bull 3635–A, 3642–43; Fife 657–58; Secrest 1065; Waters 3294, 3297; CX's 535Z–20 through Z–22, 26F– [33] G, 13P, 15J, 534Z–8). Program distribution groups are formed to enhance the ability of their members to compete with direct-buying retailers as well as other WDs and jobbers, to tie jobbers to their WDs and to undertake advertising and promotional programs which individual WDs or jobbers cannot afford on their own (Fife 657; Baumann 999–1000; Bull 3639; CX's 535Z–20 through Z–21, 566). [***] (Jursek 789; CX's 33Q *in camera*, X, 566).

146. [***] (Sheehan 537–39; CX's 14Z–4 *in camera*, 15N *in camera*). For example, American Motors Corporation ("AMC") purchases carburetor kits from Ballwin/Washington which it sells to its dealerships for use by mechanics in the dealers' service facilities (Merz 2756, 2766–67). Similarly, GM distributes carburetor kits it assembles to its car dealerships through the service channel in addition to selling kits through the traditional WD/jobber channel of distribution (Hawkins 1192).

147. [***] (CX's 163Z–9, 464A–B *in camera*, 537Z–33 through Z–34).

148. Foreign vehicle producers' sales of carburetor kits in the United States are limited to sales through their car dealerships and are generally limited to kits with application on the vehicles they manufacture (Secrest 1098–99; CX 535Z–11 through Z–12).

149. [***] (CX's 14Z–4, 15N *in camera*, 26G *in camera*, 27F *in camera*, 33L *in camera*). [***] (CX's 535Z–17 through Z–18, 541Z–36, 162Y *in camera*, 26G *in camera*, 27F *in camera*). Tomco is now the only major carburetor kit assembler selling through this channel (Thompson 343–44).

150. [***] **[34]** (Secrest 1060–61, 1065–70; McCurry 3836–38; CX 464A–E *in camera*).

151. Ballwin/Washington's national account customers included virtually all of the domestic and foreign automobile manufacturers, kit assemblers, and numerous private brand aftermarket product sellers. National account sales to private brand sellers accounted for about [***] of Ballwin/Washington's total kit sales in 1979 and for about [***] in 1980. National account sales to other kit assemblers accounted for about [***] of Ballwin/Washington's total kit sales in 1979 and for about [***] in 1980. National account sales to carburetor rebuilders accounted for less than [***] in both years (Merz 2749–58; McCurry 3837–40; CX's 464A–E *in camera*, 404A–D, 169H, 129Z–8, 165V, 163Z–9; RX's 292–305, 307, 309–30).

152. Although only GM assembles and sells kits in the aftermarket at the present time, other automobile manufacturers are potential assemblers of kits. For example, Ford manufactures Ford carburetors and, until about 1972, assembled and sold kits to the aftermarket. In 1972, although Ford had the capabilities to assemble and offer a full-line of kits, it made a management decision to purchase all kits from outside and cease kit assembly of its own, because buying kits was less expensive than assembling them (*see* Lingle 3511–18; Baumann 1001–12).

153. In 1967, Borg-Warner shifted responsibility for carburetor kit sales to WDs under the Borg-Warner name from Ballwin/Washington to APD (Merz 2715). APD, as a national account of Ballwin/Washington, served as Borg-Warner's primary distribution arm to the automotive aftermarket (Secrest 1066). [***] (CX's 24C *in camera*, 143B). In 1979, APD accounted for [***] of Ballwin/Washington's total carburetor kit sales and in 1980, for [***] (CX 464E *in camera*).

154. Borg-Warner began selling carburetor components and kits to national accounts mainly for two reasons. First, "the economies of scale at the manufacturing plant in Washington were such that the more parts you could sell, the more profits you could make" and it did not matter whether the carburetor components were sold in bulk form or in kit form (McCurry 3840–41). Second, [***] (CX 33E *in camera*) [***] **[35]** [***] (Merz 2785, 2787; CX's 26G *in camera*, 27F *in camera*, 169G). In computing its share of the carburetor kit market, Borg-Warner included its sales through APD under the Borg-Warner name as well as Ballwin/Washington's national account sales of private-branded carburetor kits to resellers (CX's 140C, 169Z–17 through Z–18). Borg-Warner viewed its kit sales to reseller customers as part of its "*base* market share of carburetor tune-up kits" (emphasis in original) (CX 140C).

155. In recent years, Carter was the only other carburetor kit assembler that sold carburetor kits to reseller national accounts (Se-

crest 1068–69; Fife 656–57; Jursek 743). However, Carter lost its last carburetor kit reseller customer, Guaranteed Parts, to Ballwin/Washington in 1981 (Sheehan 538; Eaton 2979–80; CX's 142, 184–85).

D. *Some Important Marketing Aids Provided By Kit Assemblers*

156. The major carburetor kit assemblers provide important services to their customers, including a full line of well-consolidated carburetor kits offering broad coverage for the vehicles on the road, and certain marketing and sales support services.

157. Among the marketing and sales support services provided by assemblers are cataloging service and inventory guidance, sales personnel work with the customers' sales forces, warranty, obsolescence and stock adjustment programs, training clinics, advertising and other promotional materials and programs, and a fast delivery.

158. Carburetor kit catalogs are used throughout the distribution channel to locate the appropriate kit for a specific carburetor repair job (Sheehan 465; Fife 620–21; Thompson 304–05). Accurate, complete and up-to-date catalogs are, therefore, important in the sale of carburetor kits (Brown 3397–99; Jursek 780; Thompson 349–50; CX's 217, 125 at 2, 182A, 419, 169I, 170Z–5, 168Z–5 546B). Carburetor kit catalogs (or supplements) are prepared annually by all of the major assemblers and distributed to their WD customers (Schultz 3056; Sheehan 466–67; Thompson 351–52; CX's 40–41, 249–53, 416–17, 426, 429–30, 439–41, 445). Ballwin/Washington also annually provides catalogs, supplements and other cataloging information to its national account kit customers (Secrest 1102–03; Kruse 2922–23, 2926, 2929; CX's 169K, 141, 187N, 217).

159. Carburetor kit catalogs generally contain sections cross-referencing the carburetor kit part numbers to vehicle models and to carburetor model numbers and a numerical listing of **[36]** the assembler's kits (CX's 40–41, 125 at 2, 416–17, 439–40, 445, 537Z–60). Some catalogs also cross-reference the assembler's carburetor kits to competitors' carburetor kits (CX's 429–30). Cataloging information is developed primarily from vehicle and carburetor manufacturers' manuals (Fife 621; CX 537Z–60). Comparisons to competitors' kit catalogs are also undertaken to improve the format and contents of an assembler's catalog (Sheehan 466; Thompson 306).

160. Carburetor kit assemblers also prepare and distribute interchange lists which cross-reference their kit numbers to competitors' kit numbers (CX's 169M, 170Z–5, 168Z–5, 177A–B, 267, 427A through Z–11, 419, 535Z–49, 82, 85–86, 88–97). [***] (Waters 3316–17; Bull 3656–57; CX's 535Z–28, 182A, 245I *in camera*).

161. In addition, [***] (Tehansky 846–47; CX's 123C, 245I *in camera*,

419, 442A-B, 452, 535Z-31). Each kit in the assembler's line is given a "popularity designation" or "popularity code" based on its sales history or projected sales potential. [***] (Jursek 784; Tehansky 846-47; Thompson 347; Fife 659; CX's 44, 442A-B *in camera*, 13P *in camera*). Inventory guidance is also provided to Ballwin/Washington's national account customers (Secrest 1101, 1105-06).

162. Suggested carburetor kit price lists are provided by the assemblers usually on an annual basis, to both WD and national account reseller customers (Eaton 2942; Timberlake 3093; Secrest 1101, 1104-05; Sheehan 548; Thompson 346; Merz 2772-73; CX's 188A, 192). These suggested price lists generally include suggested prices at the jobber, mechanic ("dealer" or "trade") and consumer ("list") resale levels (CX's 257-58, 45-55, 192, 449-51, 420A-I; RX's 173-75).

163. In addition, [***] (Kotcher 3575-76; Merz 2782; Waters 3317-19; CX's 33S *in camera*, 13P *in camera*, 15J *in camera*, 34U *in camera*, 534Z-5).

164. [***] **[37]** [***] (Sheehan 545, 548; Tehansky 839-40, 843-44; Nelson 1618-19; Hawkins 1170, 1192; Brown 3377; CX's 117A *in camera*, 534Z-5, 244S-T *in camera*, 419). To provide assistance to its WD customers, Borg-Warner employed a sales force of approximately 105 salesmen (CX 535Z-25); Standard employed approximately 350 salesmen (Fife 661-62); Echlin's Branford division employed approximately [***] salesmen (CX's 244Z *in camera*, 245V *in camera*, 534I, N-O; Waters 3303, 3313); Holley employed approximately 65 salesmen (Jursek 778); and Carter employed approximately 60 salesmen (Sheehan 544; Tehansky 834).

165. Of the major assemblers, Tomco is the only one that does not employ its own direct sales force. In an effort to control its distribution costs, Tomco has elected to use manufacturers' agents, which in turn employ approximately [***] commission salesmen, to distribute its carburetor kits (Thompson 288, 362; CX 570D; *see* CX 117C *in camera*). [***] (Thompson 361-62; CX's 535Z-25, 33T, V *in camera*).

166. Carburetor kit assemblers provide a limited warranty on the kits which they sell as is customary in the automotive aftermarket (Fife 666-67; Waters 3320-21; CX 541Z-25 through Z-26).

167. Carburetor kit assemblers' sales forces attempt to "changeover" WDs from competitive carburetor kit lines to their kit line (Jursek 783-84; Tehansky 840; CX's 125 at 26, 270-77). Changeovers, however, occur more frequently at the jobber level than at the WD level (Tehansky 840; CX 535Z-30). [***] (Waters 3320; Tehansky 843-45; CX's 244S *in camera*, 125 at 26, 245B *in camera*, 262A-B, 263A-C, 301-03). Once the assembler's sales force convinces a jobber to changeover kit lines, the salesman will inventory the jobber's existing kit supply, lift those kits and replace them with the assembler's kit line

(Fife 665–66; Tehansky 844–45; Waters 3320; CX's 65–67, 125 at 26, 263A, 284–87, 535Z–29 through Z–33). [***] (CX's 534Z–9 through Z–10, 73, 244Z through Z–1 *in camera*, 261A, 263A). In lieu of the "changeover" program, Ballwin/Washington provides its full-line kit customers with a stock adjustment program to offset some of the costs inherent in such changeovers (Secrest 1108–09; CX's 183, 185, 188B, 225C, 541Z–27).

168. Carburetor kit assemblers also provide their WD customers with obsolescence protection programs to facilitate the **[38]** return of slow-moving, obsolete or superseded carburetor kits (Thompson 351–54; Tehansky 847; Fife 666–67; Jursek 783; Merz 2768–69; CX's 535Z–32, 541Z–26 through Z–27). This obsolescence protection is passed down through the channels of distribution to allow inventory adjustments at the jobber level (Waters 3320–21). Ballwin/Washington provides a similar obsolescence program to its reseller national accounts (Secrest 1106–07; CX 193B–C).

169. [***] (Brown 3377; Tehansky 850, 858; Jursek 784–85; Hawkins 1193–95; CX's 429, 419, 314, 534N, 307, 309A, 313, 570D, 15J *in camera*).

170. [***] (Fife 639, 660; CX's 169M, 244Z–8 *in camera*). For example, Echlin periodically prepares comparisons of its kit prices to those of the other major assemblers for use by its customers' sales forces in selling kits at the jobber and installer level (CX's 259A, 260A–P). Similarly, Ballwin/Washington has prepared detailed comparisons of its kit line with the other major assemblers' kit lines for use by its national accounts in their kit sales efforts (CX's 105A through Z–4, 537Z–64 through Z–65, 83, 84A, 99A through Z–2, 129Z–1).

171. [***] (Thompson 347–48; Sheehan 551–52; Jursek 780; CX's 119A–C, 432–34, 244Z–8 *in camera*, 245J–K *in camera*, 117A *in camera*, 121, 123C, 125 at 2, 431A–D, 419). The purpose of such advertising is to build brand name recognition, thereby making it easier for the assembler's customers to sell that brand of carburetor kits (Fife 660–61; CX's 570D, 123C).

172. [***] (CX's 190F, 167D, 184, 232 at 3, 164Z–4, Z–10, 167D, 182A, 170Z–5, 168Z–5, 14C, N *in camera*, 26G, J *in camera*). For example, Borg-Warner used displays to compare its kits to those of Standard (Hygrade), stressing those items "which markedly show a quality difference" (CX 83). Borg-Warner also supplied its national accounts with detailed, kit by kit comparisons of the contents of competing kits (CX's 98–99, 101–02, 105A through Z–4). An assembler's reputation for providing high quality kits is, in fact, one of the critical factors WDs and resellers evaluate in selecting their carburetor kit supplier (Thompson 349–51).

173. [***] (Tehansky 848–49; Baumann 1023; Eaton 2980; Secrest

1101; CX's 535Z–33, 541Z–35, 33S *in camera*, 34W *in camera*, 133A). Thus, a carburetor kit assembler's ability [**39**] to supply products quickly after receiving an order (*i.e.*, a high "order fill rate") is important (Thompson 349–50; Timberlake 3105–06; CX's 133A–B, 76B–C). The carburetor kit order fill rates of leading assemblers are very high and range between high 80% and high 90% (Thompson 354; Sheehan 546–47; Fife 667; Jursek 781; CX's 539Z–27, 534Z–12 through Z–13, 535Z–33). Also, in order to insure prompt delivery, leading carburetor kit assemblers maintain at considerable cost a large inventory of kits they offer.

VI. THE EFFECTS OF THE CHALLENGED ACQUISITION

A. *The Market Structure Evidence*

174. At the time of the acquisition, there were seven carburetor kit assemblers or packagers offering a full line of carburetor kits and three small specialized kit assemblers that operated only in a segment of the market. And a limited number of carburetor kits were imported for foreign vehicle applications. Total sales of carburetor kits amounted to approximately 13,321,390 units in 1980 and 13,562,030 in 1979 (CX 530A). In 1980, the dollar sales of carburetor kits were about $53 million at the level of sales to WDs (Nelson 1487; Jursek 816). This would represent some $200 million spent on carburetor kits by the ultimate consumers (*i.e.*, vehicle owners) (Glassman 4386–94).

1. Firms Which Assemble And Sell Carburetor Kits

a. *Borg-Warner Corporation*

175. Prior to the acquisition Borg-Warner was the nation's largest carburetor kit assembler (CX's 81C, 530A). In 1979, Borg-Warner assembled and sold 5,106,564 carburetor kits which accounted for 37.7% of all carburetor kits sold in the United States. Its 1980 sales amounted to 4,846,396 kits or 36.4% of the market (CX's 530A–C). Borg-Warner entered into the assembly and sale of carburetor kits through its acquisition of Precision Automotive Components Company (PACCO) in 1966 (Carlson 2525–26; CX 535H). Borg-Warner sold its kits into the aftermarket both under the Borg-Warner brand name through APD and on a private label basis through sales by Ballwin/Washington to its national accounts (F. 150–51, *supra*).

176. Borg-Warner assembled carburetor kits at the Ballwin facility in Ballwin, Missouri. Carburetor parts used in its kit assembly operation were manufactured at its Washington, Missouri [**40**] plant (F. 37, *supra;* CX 539Z–14 through Z–15; Bush 2908). Borg-Warner manufactured the majority of the carburetor hard parts included in its kit line while purchasing various small parts and subcomponents such as

springs, rubber cups and clips from outside suppliers (CX's 126B, 539Z-14 through Z-16, 533Z through Z-2, Z-15 through Z-16; Bush 2909, 2915-17). At the time of the acquisition, Borg-Warner assembled a full line of carburetor kits consisting of 429 kits (CX's 164"O", 167R, 168P, 170P). Borg-Warner advertised that its kit line offered "the broadest coverage available" in the industry (CX's 120, 169I). Borg-Warner did not purchase any kits from other suppliers (CX 541R; Bush 2908). Most of its competitors purchased some kits from Borg-Warner's Ballwin/Washington Division in order to fill out their lines (McCurry 3836; Fife 648; Hawkins 1188-89; Thompson 334-35). In addition, Borg-Warner, through its Ballwin/Washington Division, also supplied carburetor parts to other carburetor kit assemblers (Thompson 326-27; Sheehan 496-98; Insalaco 919; McCurry 3836) and was considered the major full line carburetor parts supplier in the industry (Insalaco 974-76).

b. *Standard Motor Products, Inc.*

177. Standard Motor Products, Inc. ("Standard") is the nation's second largest assembler of carburetor kits. In 1979 and 1980, Standard had sales of approximately 2,889,600 and 3,169,664 kits, respectively, and accounted for about 21.3% and 23.8% of the market (CX 530A-C). Standard also offers four other products to the automotive replacement market: ignition parts, wire and cable, general service parts, and automotive air conditioning parts (Fife 610). Standard entered into the assembly and sale of carburetor kits in 1947 when it purchased Hygrade Motor Products, an assembler of major overhaul kits (Fife 615-16). During the late 1950s and early 1960's, major overhaul kits were replaced by carburetor tune-up kits (Fife 616).

178. Standard assembles carburetor kits at a plant in Edwardsville, Kansas and distributes them nationally under the "Hygrade" brand name (Fife 612-13; CX 440). Standard offers a full line of 400 to 500 carburetor kits which provide coverage for approximately 95% of all the vehicles on the road, including domestic and imported passenger cars, light and medium trucks, some heavy trucks, light tractors and other farm equipment (Fife 621-22). Standard manufactures almost all of the hard parts included in its line of kits (Fife 641-43), but generally does not offer any carburetor parts or components for sale to other kit assemblers (Fife 645). [***] (Fife 648-49; CX's 465A *in camera*, 464B *in camera*). **[41]**

c. *Echlin Inc.*

179. Before acquiring the carburetor kit business of Borg-Warner, Echlin was the third largest kit assembler. In 1979, Echlin assembled and sold 1,365,598 carburetor kits accounting for 10.1% of the mar-

ket. In 1980, its share of the market was 1,390,121 kits or 10.4% (CX's 530A–C). Echlin entered into the assembly of carburetor kits in the early 1960's (CX 538X; Schultz 3026, 3033–34). Echlin's kit line is marketed to the distribution centers ("DCs") (WD members) of the NAPA program distribution group by its Automotive Controls Corporation ("ACC") division located in Branford, Connecticut. Research and development work for Echlin's carburetor kits is also handled by ACC at Branford (CX 538F, I).

180. Echlin's carburetor kits are assembled at and shipped from the Litchfield, Illinois facility of its Brake Parts Company division (Schultz 3047–48; Timberlake 3129–30). Parts for its kit assembly operation are also purchased and inventoried by Brake Parts Company (CX 538N). Historically, Echlin purchased its requirements of carburetor parts for inclusion in kits from outside suppliers (Schultz 3040–42; Sheehan 496). At the time of the acquisition, Echlin was in the process of developing manufacturing capability for some pump plungers and diaphragms to be used in its kit assembly operation. Echlin's plan was to offer 30–40 premium carburetor kits as part of its line featuring parts made with a premium grade of fluorocarbon rubber (CX 538Z–75 through Z–77). This project was placed "on hold" in late 1981, after Echlin purchased Ballwin/Washington (CX 538Z–76 through Z–77; Smith 3235–37). [***] (Schultz 3039; CX's 538Z–9 through Z–10, 464A–E *in camera*, 467A–K *in camera*). Historically, Ballwin/Washington has been Echlin's major source of purchased kits, supplying a majority of Echlin's kits for import applications (Secrest 1070; Schultz 3061). Echlin's purchased kits accounted for less than 10% of its kit sales (Schultz 3036).

d. *General Motors Corporation*

181. General Motors Corporation (GM), through its Rochester Division, was the fourth largest producer of carburetor kits in the United States (CX 530A–C). GM's sales of kits it assembled were approximately 1,240,616 in 1979 or 9.1% of the market, and 1,072,538 kits or 8% in 1980 (CX 530A–C). GM, which is also an original equipment carburetor manufacturer, has been assembling carburetor tune-up kits since at least the early 1960's (Hawkins 1174–76). GM currently assembles kits for application on all of its own Rochester-manufactured carburetors. [***] [42] [***] (Hawkins 1175–78; CX 468B *in camera*).

182. GM assembles carburetor kits at a plant in Tuscaloosa, Alabama (Hawkins 1178). In its kit assembly operation, GM uses parts manufactured for its OE carburetor production but does not sell any kit components to other kit assemblers (Hawkins 1187). GM purchases kits for non-Rochester carburetor applications from Ballwin/Washington (Hawkins 1188–89). Its purchases from Ballwin/Wash-

ington accounted for approximately [***] of its kit sales for the period 1979–1980 (CX's 464A *in camera*, 468E *in camera*).

e. *ACF Industries, Inc.*

183. ACF Industries, Inc. ("ACF"), through its Carter Automotive Division ("Carter"), was the fifth largest assembler of carburetor kits in the United States (CX 530A–C). In 1979, Carter's sales of kits it assembled represented 7.7% of the market and its 1980 share was 7% (CX 530A–C). Carter is a supplier of OE carburetors to the automobile industry (Sheehan 464–65). Carter began assembling tune-up or "zip-kits" in the late 1950's or early 1960's (Sheehan 449, 452). Carter offers a full line of carburetor kits for sale in the aftermarket (CX's 416–18, 469B; Sheehan 463–64, 468–72).

184. Carter assembled its carburetor kits at a facility in Corning, Arkansas (Sheehan 443, 452–53), for both Carter and non-Carter carburetor applications and purchased about [***] of its annual kit sales from others, including Ballwin/Washington (Sheehan 473–75; CX 469A *in camera*). In its kit assembly operation, Carter used carburetor parts it manufactured in-house, parts manufactured by outside suppliers on a contract basis using tooling owned by Carter, and parts offered for sale by carburetor parts manufacturers such as Ballwin/Washington (Sheehan 491–94, 496–97). Carter sold carburetor parts only for Carter carburetor applications to other kit assemblers (Sheehan 496; Insalaco 985).

f. *Tomco, Inc.*

185. Tomco was the sixth largest carburetor kit assembler at the time of the acquisition. Its share of the market was approximately 6.4% in both 1979 and 1980 (CX 530A–C). Tomco is a privately-owned supplier of fuel system products to the automotive aftermarket. Its products include: carburetor kits, choke thermostats, choke pull-offs, chokes, fittings and adaptors (Thompson 285, 296). Tomco began packaging carburetor tune-up kits in 1963 (Thompson 297) and offers a full line of some 300 to 400 carburetor kits (Thompson 314; CX's 445, 447). **[43]**

186. Tomco is located in St. Louis, Missouri (Thompson 284). Its kits differ slightly from others in that they include a rotary disc fuel inlet valve, a proprietary product of Tomco, rather than a needle and seat assembly (Thompson 295–96). Tomco has its fuel inlet valve manufactured on a contract basis by an outside supplier using Tomco owned tooling (Thompson 324–25). Other carburetor parts are purchased by Tomco from carburetor parts manufacturers such as Ballwin/Washington (Thompson 326–27). Tomco also purchases certain slow-moving kits already assembled from Ballwin/Washington to fill out its line

(Thompson 334–35). Purchases of such kits account for less than 10% of Tomco's total kit sales (Thompson 2457–58).

g. *Holley Replacement Parts Division Of Colt Industries Operating Corporation*

187. At the time of the acquisition, the Holley Replacement Parts Division of Colt Industries Operating Corporation ("Holley") ranked seventh in the carburetor kit market in the United States, accounting for 3.3% of the market in 1979 and 3.4% in 1980 (CX 530A). A sister division, Holley Carburetor Company, manufactures, *inter alia*, OE and replacement carburetors for the automotive industry (Jursek 707). Holley Carburetor Company's aftermarket products are distributed by the Holley Replacement Parts Division (Jursek 708–09). Holley first began to offer carburetor tune-up kits in the late 1950's (Jursek 739). Holley offers a full line of some 600 kits under the Renew Kit name as well as two other specialized lines of carburetor kits (Jursek 715–20).

188. Holley assembles carburetor kits in Goodlettsville, Tennessee (Jursek 714). Parts for inclusion in kits for both Holley and non-Holley carburetor applications are supplied to the Replacement Parts Division by its sister division, Holley Carburetor Company (Jursek 733–34), as well as by other suppliers (Jursek 731). Holley Carburetor Company also sells carburetor parts for Holley carburetor applications to other assemblers (Insalaco 985; Secrest 1116). Holley has always assembled a majority of its carburetor kits (Jursek 738) and in recent years instituted a program designed to increase the percentage of its line that it assembles (Jursek 741–43; CX's 546B, 547A, 548A). Holley purchases kits for low-volume applications, primarily from Ballwin/Washington (Jursek 727–30). Holley's kit purchases accounted for approximately [***] of its kit sales in 1979 and 1980 (CX's 471C–D, 464A–E *in camera*). [44]

h. *Other Carburetor Kit Assemblers*

189. At the time of the acquisition, there were three other smaller kit assemblers operating in two market segments (CX's 475A–C, 476A –D, 477A–C). Royze, located in southern California, assembled and sold kits for import vehicle applications only (Merz 2733–34). Royze's kit sales accounted for about 2% of the kit market in 1979 and 2.1% in 1980 (CX 530A–C). Royze also purchases some kits from Ballwin/Washington to fill out its import car kit line (Merz 2734).

190. Facet Enterprises, Inc. ("Facet") and Tru-Part Manufacturing Inc. ("Tru-Part") both assemble and sell kits for application on off-the-road vehicles, such as tractors and earth-moving machinery (CX's 476A, 477A). Facet also assembles a very few kits for inboard marine

applications (CX 476A). Neither company assembles any carburetor kits for passenger cars (CX's 476A, 477A). In 1979 and 1980, Facet and Tru-Part together accounted for less than 1.5% of the carburetor kit market (CX 530A-C). Due to the increasing displacement of gasoline engines by diesel engines in agricultural machinery, this "agricultural and industrial" segment of the carburetor kit market has been declining steadily (Nelson 1462-63).

i. *Foreign Kit Competition*

191. Despite the growing popularity of imported cars in the United States, carburetor kits imported in 1979 and 1980 accounted for only about 1.2% of the carburetor kit market (Nelson 1482-83; CX 530A-C). This is due to the fact that demand for carburetor kits for imported cars is largely met by domestic kit assemblers (Nelson 1463-66, 1483-86). Ballwin/Washington is the primary supplier of import car kits to other domestic suppliers (Sheehan 473; Jursek 727-28; Hawkins 1188-90; Secrest 1078; *see* CX 115A), [***] (Merz 2762; Secrest 1078-80; Nelson 1464-65, 1483-86; CX 464A-E *in camera*), [***] (Nelson 1484; Secrest 1075-76; CX's 115A, 537Z-34 through Z-35, 464A-E *in camera*).

192. The small number of imported kits brought into the country primarily by foreign car manufacturers, such as Nissan, Toyota, and Honda, are sold through their dealer networks for use on their cars (Secrest 1081, 1098-99; CX's 461A-B, 478A-E, 479A-E, 480A-C, 535Z-11 through Z-12). In addition, some of the import kit resellers import a small volume of import car carburetor kits (Nelson 1464-65; CX's 461A-B, 535Z-12 through Z-14). Royze also imports a limited number of import car carburetor kits (CX's 474A-C, 461A-B). However, the record shows **[45]** that no company imports carburetor kits for use on cars of domestic manufacture at the present time (Nelson 1466).

193. It may be expected that, as imported cars continue to gain an increasing share of the U.S. car market, carburetor kit imports for foreign car applications will gradually increase. However, the record does not indicate that imported carburetor kits will capture a significant share of the U.S. carburetor kit market in the near future (Nelson 1482-84; CX 212A). [***] (CX's 24Z-3 *in camera,* 180A).

2. The Measurement Of Market Shares

194. The measurement of market shares in the carburetor kit market is complicated by the presence of some [***] so-called resellers, those firms which do not assemble kits but buy them from Ballwin/Washington (Merz 2749-59; Timberlake 3108; RX's 292-307, 309-30), and sell them under their own private labels to the wholesale channels of distribution.

195. It is settled that, once the product market is determined, as is the case here, it is appropriate to include a firm's sales to resellers (private branders) in the firm's market share for the purposes of market share analysis. *See United States v. Black & Decker Mfg. Co.*, 430 F.Supp. 729, 737–38 (D. Md. 1976); *Beatrice Foods Co.*, 3 Trade Reg. Rep. (CCH) ¶ 22,035 at 22,624 (May 26, 1983); *Champion Spark Plug Co.*, Docket No. 9141, Initial Decision at 90 n. 10, adopted by the Commission (Final Order dated June 20, 1984) [103 F.T.C. at 623]. In the instant case, although the assemblers do not "manufacture" or "process" kits, they are in a real sense "producers" of kits and the relationship between a kit assembler and a kit reseller is similar to the relationship existing between a manufacturer/processor and a reseller involved in the cases cited hereinabove.

196. Furthermore, in computing its kit market share in internal marketing documents, Borg-Warner itself included its kit sales of both APD and Ballwin/Washington (private label sales) (CX's 140C, 169Z–17 through Z–18) and viewed its kit sales to "reseller" customers as a part of its "*base* market share of carburetor tune-up kits" (emphasis in original) (CX 140C).

197. Also, unit sales are more realistic as well as more meaningful because of the distortions in dollar sales that would be introduced by the sales to and by the resellers.

198. The MEMA, an industry trade association, also collects and publishes carburetor kit sales data on a unit basis (CX 436A–B). **[46]**

3. Market Shares And Concentration Ratios

199. Prior to the acquisition, Borg-Warner's sales of carburetor kits it assembled accounted for about 37.7% of the market in 1979 and 36.4% in 1980. Standard, the second ranked assembler, accounted for about 21.3% in 1979 and 23.8% in 1980 (CX 530A–C). Echlin, the third ranked firm, accounted for about 10.1% in 1979 and 10.4% of the market in 1980 (CX 530A–C). General Motors, the fourth ranked firm, accounted for about 9.1% in 1979 and for 8% in 1980. The pre-acquisition four-firm concentration ratio in the kit market was about 78.2% in 1979 and 78.6% in 1980 (CX 530A). The pre-acquisition two-firm concentration ratio in 1980 was about 60.2% (CX 530A). Thus, the kit market was an advanced oligopoly prior to the acquisition.

200. As a result of the acquisition, Echlin increased its share of the market to 46.8%, on a 1980 *pro forma* basis, thus becoming the nation's leading kit assembler. Echlin's post-acquisition share was almost twice that of its closest rival, Standard, and almost six times that of the third ranked assembler, GM (CX 530A–C). The resulting two-firm concentration ratio was 70.6% and the four-firm concentration ratio rose to 85.6%, on a 1980 *pro forma* basis (CX 530A–C).

201. The pre-acquisition Herfindahl-Hirschman Index ("HHI") measured approximately 2,172 in 1980 (CX 530A), in the range generally considered to be "highly concentrated." As a result of the acquisition, the HHI in the kit market increased by 757 points to about 2,929, on a *pro forma* basis (CX 530A).

202. The acquisition also eliminated competition between the merging firms. In 1980, prior to the challenged transaction, Borg-Warner and Echlin were the first and third largest assemblers of carburetor kits, with 36.4% and 10.4% of the market, respectively (CX 530A). By acquiring Borg-Warner's automotive aftermarket assets, Echlin has eliminated this competition.

B. *The Challenged Acquisition Constitutes A Probable Violation Of Section 7 On The Basis Of Market Structure Evidence*

203. Under established judicial and enforcement criteria, the resulting market shares of the acquisition and the degree of market concentration in the kit market are so high that the acquisition will be a presumptive violation of the merger law and be prohibited unless it is shown that the market shares are not reliable indicia of the true competitive significance of the acquisition or that the market is likely to perform competitively regardless of the acquisition. *See* IV Areeda & Turner, Antitrust [47] Law ¶¶ 909–12 at 29–68 (1980); Sullivan, Antitrust, Sections 204a and 204b at 613–21 (1977); *BASF Wyandotte Corp.*, 100 F.T.C. 261, 392 (Initial Decision dated May 14, 1982). In the instant case, the administrative law judge will be guided by the 1982 *Statement of Federal Trade Commission Concerning Horizontal Mergers*, dated June 14, 1982 ("FTC Guidelines") and will also take into consideration the recently revised *Department of Justice Merger Guidelines* (June 14, 1984) ("DOJ Guidelines"). *Also see* Clanton, *Focusing the Inquiry: Specificity In The Merger Guidelines and Elsewhere*, 71 Calif. L. Rev. 430, 433–36 (1983); Greenfield, *Beyond Herfindahl: Non-Structural Elements of Merger Analysis*, 53 Antitrust Law J. 299 (1984).

204. The FTC Guidelines indicated the Commission's view that, while market share data remain "an important indicium of the likely competitive effects of a merger," it will employ "a more refined treatment" of such data in light of "more recent empirical economic research and well over a decade of practical experience in analyzing and evaluating horizontal mergers" and take into account "non-market share considerations," the most important of which being entry barriers. *FTC Guidelines* at 2–3.

VII. CERTAIN NON-MARKET STRUCTURE FACTORS WHICH BEAR ON THE COMPETITIVE EFFECT OF THE ACQUISITION

205. The FTC Guidelines thus mandate a further inquiry into "those additional factors relevant to the assessment of market power effects" and suggests an examination of "whether any market power conferred by the merger is likely to persist over time" (market power duration factors) and "whether market conditions are conducive either to the exercise of individual firm market power or to collusive-type behavior." *FTC Guidelines* at 3–4.

206. Such additional factors relevant to the assessment of market power effects of the challenged merger include two marketwide conditions in the carburetor kit market, namely, the restraining influence of substitute products and the limited power of kit assemblers to control competition by resellers.

A. *Substitute Products Compete With Carburetor Kits*

207. Although new and rebuilt carburetors are not close-enough substitutes for carburetor kits to be included in the same product market, rebuilt carburetors will have a significant restraining influence upon the market power of the merging firms.

208. The record is clear that the firms in the carburetor kit market regard rebuilt carburetors as competitive products, that they are generally aware of the price range of rebuilt [48] carburetors, that there is a general relationship between the prices of the two product groups and that there is a general perception that the price movements of rebuilt carburetors may affect the sale of kits to some degree.

B. *Kit Assemblers' Power To Control Competition In The Kit Market Is Limited*

209. In measuring market shares, the private brand sales of Ballwin/Washington to some 40 resellers were included in Borg-Warner's market share. However, the record shows that Borg-Warner's power to control competition in the kit market is limited in important respects. And this fact serves to diminish the significance of the merging firms' market shares as a surrogate measure of their market power.

210. For example, Borg-Warner had no control over the terms of sale of private brand kits by its reseller customers (Eaton 2959; McCurry 3847; Secrest 1133). The assemblers also have only a limited control over the design and quality of private brand kits. And in many cases, the design, quality and consolidation of a kit is determined by the reseller alone or in consultation with the assembler (*see* RPF 658–68). The evidence also shows that the contents of kits for each vehicle are more or less standard regardless of the seller (Sheehan

477; Hawkins 1185). The consolidation decisions, once critical to competition, are no longer a difficult task and most firms appear to have similar consolidation patterns today (Merz 2786; Tehansky 872). There also appears to be a great deal of design copying among competitors (Fife 690; Tehansky 853; Eaton 2975; Smith 3172).

211. The resellers sold kits not only in competition with APD but also with other kit assemblers. Most kit assemblers regarded resellers as their competitors. The buyers (WDs, jobbers and installers) made no distinction between assemblers and resellers (*e.g.*, Thompson 413, 2482; Carlson 2648–49; Merz 2740).

212. The evidence shows that most of the national accounts follow Ballwin/Washington-suggested price lists (CX 225B). However, this evidence does not prove that the resellers do not have the freedom to set their own prices. In fact, there is testimony that the national accounts are able to exert some influence on Ballwin/Washington's pricing decisions (Eaton 2946–47).

213. Analysis of price changes of some kit resellers, although based on selective and incomplete data, suggests that these resellers appeared to have enjoyed significant freedom to pursue their own pricing strategies, indicating a significant limitation on Borg-Warner's power to control kit prices (*see* RX's 348–54; Glassman 4067–75, 4088–97, 4114–17, 4142–43). This **[49]** is not surprising in view of the fact that Ballwin/Washington sells kits to resellers at the same prices it charges APD and that resellers enjoy about the same gross margins (from 33% to 40%) as APD (McCurry 3855–56) in the pricing of purchased kits.

214. The power of kit assemblers over kit prices is also significantly limited by competition from substitute products, especially replacement carburetors, which places a significant constraint on the market power of the merging firms. *See FTC Guidelines* at 12.

C. *Entry Barriers Are Very Low*

215. In the Commission's view, entry barriers "is perhaps the most important qualitative factor" in determining the probable impact of a merger "for if entry barriers are very low it is unlikely that market power, whether individually or collectively exercised, will persist for long." *FTC Guidelines* at 3–4.

216. The record is clear that entry into the assembly and sale of carburetor kits is rather easy and that entry barriers are very low.

217. Complaint counsel assert that economies of scale (CPF 286–93), parts production or procurement barrier (CPF 295–308), sunk costs (CPF 308–14), and product differentiation (CPF 314–19) constitute substantial entry barriers into the carburetor kit market, relying largely on the testimony of Dr. Steven R. Nelson, their expert witness.

218. The record, however, does not show the presence of such commonly recognized entry barriers as legal license, patents and other secret processes, control over scarce resources, entrenched buyer preferences or product differentiation and high capital costs (Glassman 4215–38). *See generally*, II Areeda & Turner, Antitrust Law, ¶ 409 at 298–306 (1978).

219. The record does not show the presence of any significant technological barriers to entry into the assembly of carburetor kits. Although some assemblers use patented components, patents and secret processes do not hinder anyone from starting a kit assembling operation.

220. The record does not show that kit assembly requires a high degree of technological know-how. Although the development and maintenance of a kit line requires a degree of knowledge about automotive carburetors and some expertise is involved in kit consolidation and component procurement ("sourcing"), there is no evidence to show that such knowledge or skill is scarce or prohibitively expensive. Indeed, the kit industry was started by automobile mechanics and automotive products salesmen with **[50]** enterpreneurial vision. And, the kit assembly itself is performed by semi-skilled workers and requires minimal training.

221. The record does not show any significant production barriers such as control of scarce resources. Although the record is clear that the kit component manufacturing capability, achieved through backward integration, is a distinct competitive advantage in kit assembly and that the leading kit assemblers (now including Echlin) do make most of the major kit components, the record also shows that there are sufficient numbers of alternative sources of supply for kit components (*see* RPF 42–47, 404–22). At any rate, the record does not show, and complaint counsel do not suggest, that entry is possible only with kit component manufacturing capability.

222. The record fails to show that a new entrant must bear heavy promotional costs and overcome deeply entrenched buyer preferences. Brand loyalty appears to be no longer an important factor in the sale of carburetor kits, whatever its importance may be now in the marketing of other aftermarket products. Although kit suppliers (both assemblers and resellers) use brand names, kit installers seldom specify brands when ordering. It is also true that customers at all levels of distribution want to carry quality products and that a reputation for quality products is a valuable marketing tool. However, the record is clear that product quality in the kit market is taken for granted today and that this fact is largely responsible for the diminishing brand loyalty in the kit market (*see* F. 51–52, *supra*).

223. Although there is some evidence showing that a new entrant

will face some buyer resistance until its products become known in the aftermarket channels of distribution (CPF 319), the record also shows that "changeovers" are common occurrences both at the WD and jobber levels (F. 167, *supra;* CPF 142–43).

224. The only distributional barrier in the kit market appears to be the need to develop and maintain a full line of kits not only for the multitude of old model carburetors but also for numerous new model carburetors as they appear each year (F. 127–30, *supra*). It is reasonable to conclude from the evidence that a new entrant would be unable to compete effectively until it attains a full-line or near-full-line capability. However, the record also shows that a would-be entrant can enter the kit market with a limited line of conventional or modified kits and gradually expand its line.

225. However, with respect to the so-called national accounts or resellers (of private brand kits) which historically have purchased their kit requirements from Borg-Warner's Ballwin/Washington Division, a considerable degree of buyer preference for Ballwin/Washington appears to exist. This is not surprising in view of the fact that for some years Ballwin/Washington has been the sole source of private brand kits for resellers until November 1981, when Sherman Carburetor **[51]** Company, an established basic manufacturer of carburetor and carburetor kit components, began soliciting the national account business in competition with Ballwin/Washington (*see* F. 243, *infra*). The record shows that Sherman has made only a modest gain in this venture in spite of substantial price concessions it offered. Sherman's lack of success, however, may be due largely to its failure to offer a full-line of kits to the national accounts or private brand sellers who offer a full-line to WDs and would rather buy their kit requirements from a single source until Sherman becomes a full-fledged second source of a full line of private brand kits (*see* F. 244, 252, 254 *infra*).

226. Capital costs in the sense that entry requires a large absolute expenditure of funds do not constitute a "barrier to entry" unless they are so high as to be prohibitive. A new entrant may of course have to pay higher interests than established firms, but this will likely be the case in all industries. *See* II Areeda & Turner, ¶ 409e. Capital costs for starting a kit assembly operation are rather modest (*e.g.*, Carlson 2545–49, 2558–64).

227. Complaint counsel's "economies of scale" argument, simply stated, is that (1) since each of the leading firms either accounted for 10% or more of the total market sales in 1980 or possessed the capacity to assemble that many kits, the minimum efficient scale operation in the kit market is about 10% of the market or 1.3 million units, and (2) since the minimum efficient scale operation is 10% of the market

sales, scale economies are substantial and will seriously impede entry (*see* CPF 281–94).

228. At the outset, the evidence relied on by Dr. Nelson, the government's expert witness, for his conclusion that the minimum efficient scale for entry into the kit market is 10% of total sales is insufficient to establish Dr. Nelson's sweeping conclusion and is not persuasive (*see* CPF 293–94).

229. Not surprisingly, the record shows that some of the familiar elements contributing to scale economies, such as higher volume efficiency realizable in machinery and plant cost (Nelson 1592, 1596–97), labor cost (Nelson 1586–87, 1593–95) and materials cost (Nelson 1597–98, 2164, 2245–46, 2261), are also present in the kit assembly operation. Thus, it is safe to conclude that scale economies do exist in the kit market. However, there is evidence indicating that scale economies in the kit assembling operation are "inconsequential" and less significant than those present in the manufacture of carburetor and carburetor kit components (*see* McCurry 3840–45).

230. As Areeda and Turner put it succinctly, however, to the extent that scale economies impede entry, it is not because new entrant is unable to produce at the same cost as incumbents (as it would be usually the case in most industries), but because entry at minimum-cost scale (or minimum efficient scale) would so expand the supply as to depress the price and profit that entry **[52]** would not be attractive. This may very well be the case in many small markets such as the kit market (1980 sales of about $55 million). From an antitrust policy point of view, to call this a "barrier to entry" would be somewhat incongruous. *See* Areeda & Turner, II Antitrust Law, ¶ 409.

231. Also, there is a school of thought which holds that economies of scale do not deter entry, especially in cases where capital costs associated with entry are low (Glassman 4273–77). The carburetor kit market is such an industry.

232. In terms of market power assessment, it has been suggested that even where the minimum efficient scale or economies of scale severely limit the number of firms that can operate profitably in the market, the incumbents will have no "meaningful market power" if sunk costs associated with entry are low. *See* Wentz, "Mobility Factors in Antitrust Cases: Assessing Market Power in Light of Conditions Affecting Entry and Fringe Expansion," 80 Mich. L. Rev. 1545, 1591 (1982), cited in RPF at 214 n. 43.

233. "Sunk costs" is that portion of capital costs associated with entry which cannot be recovered if a would-be entrant decides to exit from the market. High sunk costs can impede entry into a market (*see* Nelson 1575–77, 2011–12; Glassman 4240–44; Willig 4776–78).

234. Dr. Nelson testified essentially that, although the absolute

capital necessary to enter the kit market is not sufficiently large as to impede entry, the portion of initial entry costs that constitutes sunk costs is sufficiently high to deter entry (CPF 309). Dr. Nelson then enumerated and elaborated on the main components of sunk costs, such as "development expenditures," inventory costs and promotional costs (CPF 310–13).

235. However, the record shows that entry costs in terms of capital costs are rather modest to begin with. "The development expenditures" and promotional costs associated with entry would largely be unrecoverable in most industries. According to Dr. Nelson, as a rule of thumb, 50% of inventory costs may be unrecoverable (Nelson 2026–27). From the foregoing, it is fair to conclude that there are sunk costs associated with entry into the kit market, but the evidence does not show that the sunk costs are sufficiently high to deter entry whether considered alone or in conjunction with the economies of scale discussed hereinabove.

236. From the foregoing discussions, it is concluded that barriers to entry into the carburetor kit market are very low and are not likely to impede entry that may otherwise be expected to occur in response to noncompetitive performance in the carburetor kit market. [**53**]

237. The evidence relating to the recent history of new entries is somewhat mixed in that the record shows only one substantial entry during the last decade in addition to a number of small-scale entries during the same period.

238. Former president of Borg-Warner's APD division testified that Nissan and Toyota of Japan began marketing carburetor kits in this country sometime during 1974 through their dealer organizations and Japanese trading companies. However, they have not yet achieved significant sales volume (Merz 2727–32).

239. Tru-Part Manufacturing Company, a reseller of industrial and agricultural kits, began to assemble a line of kits sometime during the last ten years, but its sales are believed to be small (RPF 928).

240. Sherman Carburetor Company ("Sherman") is an old manufacturer of carburetor parts which began its business in 1939 (Insalaco 887). As of 1982, Sherman made pump plungers, pump diaphragms and economizer valves, assembled needle and seat using purchased parts and also purchased gaskets and other miscellaneous small parts to complete its line of carburetor parts, which were sold to carburetor rebuilders and kit assemblers (Insalaco 886, 904–05).

241. When PACCO began to offer carburetor kits in the 1950's, one of the firms selling carburetor overhaul kits was Sherman Carburetor Company (Carlson 2535). In the mid 1960's, Sherman stopped selling kits (Carlson 2539). The record does not disclose the reason for Sherman's exit. From the mid 1960's until the late 1970's, Sherman nei-

ther packaged nor sold carburetor kits. It was, however, a leading manufacturer of carburetor parts for sale in bulk to carburetor rebuilders and kit packagers.

242. In 1978 or 1979, Sherman was bought by John Roberts (Carlson 2539; Insalaco 887). Mr. Roberts had no prior experience with carburetors (Insalaco 888–89).

243. In early 1981, Sherman made a decision to enter the kit market (Insalaco 920). Sherman had been assembling a small number of kits for export into Mexico since at least 1979 (Insalaco 919; CX 457C) and hired additional personnel to assist with its carburetor kit program (Insalaco 974). As a well-established manufacturer of replacement carburetor parts, it was in a good position to enter the kit market (Nelson 1649). In November of 1981, Sherman began soliciting kit sales (Insalaco 888). Angelo Insalaco, a sales representative for Sherman with many years of experience in the automotive aftermarket, was placed in charge of Sherman's kit sales (Insalaco 895). Sherman first approached national account customers hoping to be a second source of carburetor kits to the private brand sellers (Insalaco 928–30). **[54]**

244. The original line assembled by Sherman was a short line of some 120 kits limited to fast moving kits (Insalaco 929). The kits were exact copies of the Ballwin/Washington kits, and were priced about 20% lower (Insalaco 929). Sherman did not offer a catalog (Insalaco 930). The line was intended to be used as a free-standing short line or as a second source to fill out a line from another kit supplier (Insalaco 930). Sherman intended to expand to a full line in a few years (Insalaco 932).

245. The Sherman kits are sold only as a private label brand offered to national accounts (Insalaco 932). One reason for this decision was that Sherman decided it was possible to sell to national accounts without offering a catalog or other services, because they could provide their own catalogs and services, but sales to individual WDs would require such services (Insalaco 939–40).

246. Sherman's first sale of kits was in February 1982, three months after the decision was made to begin assembling kits and two months after Insalaco began soliciting sales (Insalaco 935). The sale was to Sorensen, which purchased 3,000 to 8,000 kits per month (Insalaco 935–36).

247. In the next few months, Sherman obtained the Cantire account which purchased about 1,000 kits per month (Insalaco 935). American Parts System also purchased about $26,000 of kits (Castagna 3748–49). Sherman also made a sale of unspecified size to Niehoff (Eaton 2951–53). In fact, within two years of the decision to assemble kits,

Sherman had made some sales of kits to most of Ballwin/Washington's national accounts (Timberlake 3131).

248. Sometime in 1981, around the time that Sherman first decided to assemble kits, it assembled on contract 50,000 Easy Way kits for Allparts (Carlson 2553).

249. Sherman also began soliciting sales to Bumper-to-Bumper ("BTB") and Pronto, two program distribution groups in June or July 1982 (Insalaco 937). At least one sale was made to Pronto, but the record does not disclose the amount of Pronto's purchases.

250. The BTB program distribution group is ten years old, and has 15 domestic WDs and one Canadian WD member (Brown 3384; Bull 3635–A). BTB contracted with Sherman to buy a short line of 50–60 kits bearing the Rockhill brand name. The 50–60 kits will provide 80% coverage, domestic and import (Brown 3391–92). It is expected that for the present the BTB members will carry the Rockhill (*i.e.*, Sherman) short line of fast moving kits, plus a full line of kits with a different brand name (Bull 3683–85). Sherman has not included catalogs or a return privilege in its sales to BTB, though catalogs will be provided when Sherman expands to a full line (Bull 3686–87). [55]

251. BTB has annual kit sales of about $1.2 or $1.3 million (Bull 3675). Mr. Bull, its Vice President and General Manager, estimates an average cost of slightly less than $5/kit, which would produce his WD an annual kit volume of 30,000 to 35,000 kits (Bull 3665). Using $5/kit as an average, BTB WDs have sales of 240,000 or 260,000 kits. BTB, as a whole, will probably purchase 10% to 15% of its kits from Sherman (24,000 to 39,000 kits per year) (Bull 3697–98).

252. However, two years after it entered the kit market, Sherman's total monthly sales of carburetor kits amounted to no more than $16,000 and the company was losing money (Nelson 2266; Willig 4899 –900).

253. During the summer of 1983, ACF Industries ("Carter"), a kit assembler which ranked fifth in the kit market in 1980, decided to cease its kit assembling operation and become a reseller (Sheehan 528–29). After Sherman and Ballwin/Washington made sales presentations, Carter chose Sherman as its supplier of private label kit requirements. A former Carter employee testified that Carter chose Sherman over Ballwin/Washington mainly because Sherman quoted a significantly lower price [9% lower] (Lehman 5016). Carter was expected to complete the transition from a kit assembler to a reseller sometime in 1984 (Sheehan 536–37).

254. There is testimony in the record that Sherman was at one time threatened with parts cut-off by Ballwin/Washington (Insalaco 975–76) and that both Sherman and Carter entertained some doubt as to whether Ballwin/Washington would continue to supply Sherman

with carburetor parts needed to fill out the kit line (Lehman 5032–33). There is also testimony that at the time Sherman was buying about 20% of its carburetor parts requirements from Ballwin/Washington (Lehman 5033) and that it would take Sherman "a couple of years" to be able to offer a full line of kits on its own (Insalaco 932). The record shows that Sherman's dependence on Ballwin/Washington parts has been reduced to about 10% (Lehman 5034).

255. Ballwin/Washington became aware of Sherman's entry almost immediately (Eaton 2954). Throughout 1982 Ballwin/Washington monitored Sherman's prices. When a new price list came out in late 1982, Ballwin/Washington held down its price increases on a number of kits to remain competitive with Sherman's lower prices (Eaton 2954–56). As Sherman became more successful, Ballwin/Washington reduced prices on some kits. In August 1983 (shortly after Carter decided to buy its kits from Sherman), Ballwin/Washington lowered the prices on 19 of its fastest moving kits, ranging from 5% to 30% for each kit (Timberlake 3098–99; Lehman 5040–41).

256. From the foregoing, it appears that Sherman has made a good start towards becoming an alternative source of supply of carburetor kits to the private brand sellers and that its **[56]** position will become more secure as it attains greater degree of self-sufficiency with respect to carburetor parts.

257. Sherman's attempts to sell carburetor kits to program distributors have also made impressive gains. However, it has not been able to compete with the leading firms across the board mainly due to its lack of a full line and its inability to offer marketing services, such as catalogs and promotional aids, to WDs at the present time.

258. Allparts, Inc. ("Allparts") was formed in 1969 by Merton Carlson, who had founded Precision Automotive Components Company ("PACCO") and conceived what is known today as carburetor tune-up kits (Carlson 2525, 2527–28). PACCO was sold to Borg-Warner in 1966 (Carlson 2526).

259. In 1973, Allparts became a reseller of carburetor kits assembled by the Ballwin/Washington Division of Borg-Warner (Carlson 2546). For the past ten years, Allparts has sold Ballwin/Washington's line of carburetor kits under the "Auto-Mech" trade name, which was owned by Borg-Warner until the challenged transaction and is now owned by Echlin (Carlson 2602). Allparts' continued use of the "Auto-Mech" trade name is contingent on Echlin's willingness to renew its annual contract with Allparts (Carlson 2603–04).

260. Allparts has never assembled carburetor tune-up kits similar to what it has been buying from Ballwin/Washington since 1973 (Carlson 2573). Mr. Carlson testified that Allparts has never considered assembling a line of kits similar to the one it currently resells,

in part because Allparts does not have a sufficient volume of sales of the Auto-Mech kits (Carlson 2575–76). In 1980, Allparts resold approximately [***] carburetor kits purchased from Borg-Warner (CX 464A *in camera*). These sales represented approximately 1.16% of all carburetor kits sold in the United States in 1980 (CX 530A).

261. In 1980 or 1981, Al Stefan, a former car mechanic, designed a new kit line called Easy Way (Carlson 2549, 2551). The Easy Way line has 108 kits in it (Carlson 2551). Because the line is highly consolidated, it has the same coverage as the 380–kit Auto-Mech line purchased from Ballwin/Washington (Carlson 2551).

262. The Easy Way line was originally purchased from Ballwin/Washington and Sherman (Carlson 2552–53). The Easy Way line was fully designed and consolidated by the reseller, and the assemblers merely carried out the packaging function (Carlson 2549, 2552). The first order was for 50,000 kits from each of Sherman and Ballwin/Washington (Carlson 2553).

263. After the first order, Allparts purchased the Easy Way line kits from Sherman for about one year (Carlson 2555). In late 1982, Allparts decided to assemble the line itself (Carlson **[57]** 2555). One of the factors which induced this decision was that Sherman increased its packaging fee (Carlson 2556).

264. The Easy Way kits are assembled in the basement and first floor of Mr. Carlson's home (Carlson 2558–59). Mr. Carlson's description of the facilities used in this packaging is indicative of the ease, low cost and short time span involved in beginning a modest kit assembling operation (Carlson 2562–63). Using rudimentary facilities, two employees earning $4/hour are able to package 4,000 kits per week, or an annual rate of about 200,000 kits (Carlson 2562, 2564).

265. Allparts has no sales employees but relies on independent manufacturer representatives (Carlson 2564) as does Tomco. This is a satisfactory arrangement for Allparts and helps to reduce costs (Carlson 2564).

266. The market acceptance of Easy Way kits appears to have been limited. Easy Way kits contain fewer parts than standard carburetor tune-up kits (Carlson 2551). They contain fewer gaskets and small parts, no economizer or power valves, no flange gaskets, and in some instances, only a replacement rubber cup rather than an entire pump plunger assembly (Carlson 2589–90). There are only 108 Easy Way kits as compared to 350–380 kits in the standard carburetor tune-up kit line that Allparts resells (Carlson 2551). Allparts has attempted to market Easy Way kits primarily to mass merchandisers. chain stores and discount houses (Carlson 2552, 2563).

267. [***] (CX 162Y *in camera*).

268. In 1982, Sorensen, a reseller of the standard line of carburetor

tune-up kits assembled by Ballwin/Washington, inquired whether Ballwin/Washington would be interested in producing kits similar to the Easy Way kits for resale by Sorensen (Eaton 2977). Mr. Eaton, Ballwin/Washington's Director of Sales and Marketing, informed Sorensen that it would not be economical for Sorensen to sell this type of kit or for Ballwin/Washington to assemble it (Eaton 2977). Mr. Eaton also testified that in his opinion, the Easy Way kit concept was not a proper marketing approach and that the traditional channel of distribution, through WDs, would not be interested in this type of kit (Eaton 2977–78).

269. In March of 1983, Mr. Merz, then President of the BWD subsidiary of Echlin, testified that BWD had no intention of marketing an Easy Way-type kit because the concept had not been successful and demand for these kits was extremely limited (CX 535Z–15 through Z–17). Mr. Merz explained that the Easy Way [**58**] kits were directed at mass merchandisers, rather than WDs. Mr. Carlson testified that many mass merchandisers (such as Montgomery Ward, K-Mart, Woolco, Sears and J.C. Penney) did not carry carburetor kits and that, in fact, a number of these companies had carried carburetor kits in the past but had discontinued carrying them (Carlson 2586–87).

270. Allparts began selling Easy Way kits in 1981 but its volume of sales in both 1981 and 1982 was far lower than the company's projections (Carlson 2592). Mr. Carlson agreed that the sales of Easy Way kits were "very bad, compared to what they should have been" (Carlson 2605). In fact, sales of Easy Way kits in 1982 amounted to only 40,660 kits. Allparts' most hopeful projections for sales in 1983 and 1984 were 42,000 and 44,000 kits, respectively (Stefan 2689). Thus, even assuming that total U.S. sales of carburetor kits remained steady between 1980 and 1984, Allparts' projected 1984 sales of Easy Way kits, four years after development of the Easy Way kit line began, would account for no more than one-third of 1% of all carburetor kits sold in the United States (Glassman 4498).

271. The Allparts/Easy Way experience shows that a small firm on a modest budget can design a line of kits, have another firm package it or take over the packaging function itself and become a viable business, albeit not as a full-fledged competitor.

272. Many of the witnesses who testified in this proceeding have been involved with the packaging and sale of carburetor kits since the inception of the consolidated kit in the 1950's and 1960's. The majority of these witnesses testified that entry in the carburetor kit business in the early days was simple. They also expressed their view that entry at the present time would be no more difficult, and in some ways easier, than it was 25 years ago (*see* RPF 974–1001). A manufacturer

of gaskets used in carburetor kits expressed a contrary opinion (Secrest 1119–20).

273. Thus, the evidence shows that entry barriers to the assembly and sale of kits are very low. Although the recent entry history is somewhat mixed, the relative paucity of substantial entries does not necessarily imply high entry barriers. *See The Grand Union Co.*, Docket 9121 (July 18, 1983) at slip op. 46 [102 F.T.C. at 1063]. Rather, the record as a whole is consistent with the view that the mixed history of recent entries at the assembly level may be due to the relatively small size of the kit market ($53 million) and the presence of some ten assemblers in the market as well as to sufficiently attractive profit opportunities enjoyed by the private brand sellers of purchased kits (*see* F. 152, 213; Sheehan 529–31). **[59]**

D. *The Evidence Does Not Show A Trend To Increasing Concentration Or Undue Reduction In The Number Of Sellers*

274. From the small number of industry members discussed in VI.A. hereinabove, and the market share table in evidence (CX 530A–C), one might conclude that the number of sellers in the kit market is small and that the challenged acquisition brought about a further reduction in the number of sellers, approaching the critical threshold of 10 to 12 (*see* Areeda & Turner IV Antitrust Law, ¶ 911a and b at 60–62).

275. However, because of the existence of some 40 to 50 resellers, the carburetor kit market has not experienced an undue reduction in the number of sellers (*see* RX's 292–307, 310–15, 317–30, 282).

276. In addition, the evidence fails to show a tendency towards increasing concentration. The record is bare of any direct evidence showing the direction of concentration over time one way or the other. However, it is fair to say that over the last decade, the number of carburetor kit assemblers has remained more or less constant, while the ranks of resellers (or private brand sellers) expanded. Also during the late 1970's and early 1980's, a number of firms have entered, either as assemblers or resellers. The market penetration attained by these entrants, however, appears to be rather modest.

277. The market share evidence in the record is limited to two years and does not permit an informed determination of the market-share stability issue.

E. *Competition From Imports*

278. The evidence shows that imports of carburetor kits are small and that the demand for carburetor kits for import cars are largely met by domestic kit assemblers (*see* F. 191, *supra*).

279. However, the evidence also shows that import cars have ac-

counted for an increasing portion of new cars in recent years and that some Japanese car manufacturers have begun to bring into this country carburetor kits to be sold through their dealer organizations and Japanese trading companies (*see* F. 192–93, *supra*). Therefore, it is reasonable to conclude that import competition will increase with respect to kits for import car application. **[60]**

F. *The Carburetor Kit Market Is Undergoing A Radical Technological Transformation*

280. A rapid technological change is another market factor relevant to the assessment of market power effects of a merger for market power may be harder to exercise or less likely to endure in the face of such a change. *FTC Guidelines* at 4–5.

281. Due to adoption and installation of the so-called TBI in the place of conventional carburetors in increasing number of new vehicles in recent years, the carburetor kit market is faced with a gradual diminution and transformation during the coming decades. Although the evidence indicates that the kit assemblers would be able to make the necessary adjustment and remain viable factors in the TBI tune-up kit business, this prospect is unsettling to kit assemblers and provides significant market dynamics (*see* F. 75–77, *supra*). To that extent, market power in the kit market is less likely to endure and may be harder to exercise.

VIII. EVIDENCE RELATING TO MARKET PERFORMANCE

A. *Product Innovation And Improvement*

282. The evidence shows that the record of product improvement and innovation in the carburetor kit market has been satisfactory.

283. The evidence shows that the time lag between the appearance of a new carburetor model on new vehicles and the introduction of carburetor tune-up kits for that model in the aftermarket is about 12 months (Merz 2723–24; Rivet 2824).

284. The evidence also shows a series of significant product improvements over the years, including incorporation of viton parts in the needle and seat subassembly and introduction of highly fuel resistant elastomer components in pump plungers and diaphragms (*see* F. 119, 136, *supra*). In recent years, a few kit assemblers have also introduced TBI tune-up products in response to incorporation of TBIs in some new vehicles.

285. The evidence also shows that the record of kit consolidation which increases distribution efficiency as well as user convenience has been rather remarkable in the assembly and sale of carburetor kits since its inception. **[61]**

B. *Price Competition*

286. Ballwin/Washington did not publish "list prices" to WDs as such, although it published suggested jobber net prices, from which WD prices could be derived. Other assemblers published price lists which they seldom discounted (Sheehan 601–03; Tehansky 856–57). The record is silent as to price competition among the numerous private brand sellers. However, the record as a whole does not reflect vigorous price competition among competing sellers, and competition is rather waged in non-price terms, such as completeness of the kit line and various marketing aids generally provided by kit assemblers (*see* F. 156–73, *supra*).

287. [***] (Nelson 1503–04; CX's 28Z–12 *in camera*, 29Y *in camera*, 30Z–9 *in camera*, 162W *in camera*).

C. *The Evidence Fails To Show Supra-Competitive Profits In The Kit Market*

288. Complaint counsel assert that "profitability" in the assembly and sale of carburetor kits is "high" and "well above competitive benchmarks" (*see* CPF 243–65). However, the record is devoid of any empirical data directly addressing the long-run profit levels of the carburetor kit assembly market that will permit a determination of whether the relevant product market has enjoyed supra-competitive profits over time, which may be indicative of noncompetitive market performance.

289. Complaint counsel largely rely on the opinion testimony of Dr. Nelson who used CX's 543 and 544 for the purpose of reconstructing the accounting profits of a hypothetical kit assembler at the 1.5 million unit level and concluded that the profits likely to be realized by "leading firms" in the assembly and sale of carburetor kits are substantially higher than the QFR figures for "all manufacturing" for any year during the 1978–1982 period. However, Dr. Nelson's analysis of a hypothetical profit model and conclusions derived therefrom essentially lack that degree of probity which will support a finding on such a key issue as the market's long-run profit levels.

290. [***] (*e.g.*, Secrest 1114; Nelson 1511–12, 2303–05, 5143–46, 5286–87; CX's 162Z–4 *in camera*, 618–22 *in camera*). However, such evidence, while suggestive, is fragmentary and falls far short of what would be required for an informed determination of whether the profit levels of the kit assembly market over time have been **[62]** consistent with a competitive performance or the contrary is the case.

291. The record also contains testimony of some knowledgeable industry witnesses that carburetor kit assembly is not an especially

rofitable venture compared to some other product lines in the after-narket (*see* RPF 860–63).

D. *The Smaller Firms Are Profitable And Appear To Be Able To Grow*

292. The evidence shows that the smaller firms in the kit market, uch as Carter, Tomco and Holley, have been profitable and able to grow (*see* Thompson 310, 369; Sheehan 557; Jursek 738, 777–78; CX 530). And the recent exit of Carter from kit assembly is not related o any adverse market conditions Carter faced in the kit market Sheehan 527–31). Thus, the record is consistent with competitive performance of the kit market as a whole.

IX. THE EVIDENCE RELATING TO FACTORS OTHER THAN MARKET SHARES IS SUFFICIENT TO OVERCOME THE SUBSTANTIAL ANTICOMPETITIVE POTENTIAL OF THE ACQUISITION INFERRED FROM MARKET SHARE EVIDENCE

293. The anticompetitive potential of the challenged acquisition is substantial as predicted by the combined market shares of Echlin and Borg-Warner in the carburetor kit market. In such a case, other non-market share factors may be given less weight. *See FTC Guidelines* at 6.

294. In the instant case, however, the administrative law judge is persuaded that the nature and quantum of the record evidence related to market factors other than seller concentration, including low entry barriers (F. 215–73, *supra*), to factors affecting the significance of market shares (F. 207–14, *supra*) and to the radical technological change brought on by the throttle body injection system (TBI) which promises to make carburetors and carburetor kits obsolete in a decade (F. 75–77, *supra*), collectively and cumulatively, are sufficient to overcome the adverse inference based on market share evidence. *Cf., United States v. General Dynamics Corp.*, 415 U.S. 486, 501–02 (1974).

295. Of the evidence generally recited in the preceding finding, some merits particular emphasis. First, over [***] of Borg-Warner's 1979 kit market share and almost [***] of its 1980 share were "national account" sales to resellers, Borg-Warner's kit sales under the Borg-Warner name accounting for the remainder in both years. As for Echlin, it was the only one, among the top seven kit assemblers, which lacked *any* parts manufacturing **[63]** capability; all the others manufactured some or most of the components that made up the carburetor kits they sold. By acquiring the aftermarket divisions from Borg-Warner, Echlin, among other things, acquired that capability. In this perspective, the substantial anticompetitive potential predicted by

the combined market shares of the merging parties must be discounted accordingly.

296. The second important factor which merits particular emphasis is the condition of entry. The record is clear that entry barriers into the assembly and sale of carburetor kits are virtually nonexistent or very low.

297. The third factor which merits some emphasis is that direct competition between Borg-Warner and Echlin was not as large as the *pro forma* market shares of the merging firms may suggest. Echlin has never sold, nor tried to sell, any carburetor kits to any customer other than NAPA, a large program distributor group (F. 6–8, *supra*). While APD sold to the traditional channels of aftermarket distribution of which NAPA is a part, Ballwin/Washington did not sell directly to the WD/jobber channel but only to national accounts (which sold to the WD/jobber channel).

298. From the foregoing, it is safe to conclude that the long-term anticompetitive effect of the challenged acquisition is not likely to be substantial. With respect to short-term effects, the question is a closer one. However, the non-market share factors discussed hereinabove, including the significant restraining force emanating from rebuilt carburetors, together with ease of entry coupled with the presence of numerous potential entrants, including Ford, Chrysler, AMC and other large resellers of kits (F. 150–51, *supra*), are sufficient to check any adverse short-term effect which may be inferred from the market share evidence.

299. Accordingly, on the basis of the record as a whole, it is found that the effect of the challenged acquisition is not likely to lessen competition substantially in the assembly and sale of carburetor kits. **[64]**

DISCUSSION

This case involves the 1981 acquisition by Echlin, a manufacturer and marketer of a wide range of automotive aftermarket products, of the assets and business of Borg-Warner's five aftermarket divisions, including Automotive Parts Division ("APD") and Ballwin/Washington Division ("Ballwin/Washington"). Echlin also obtained from Borg-Warner a license to sell aftermarket products of the acquired divisions under the Borg-Warner name and a supply agreement covering certain Borg-Warner products Echlin may need for the continued operation of the acquired divisions.

The complaint challenges the acquisition because of its alleged anticompetitive effect in the carburetor kit segment of the automotive aftermarket and seeks the divestiture of the acquired divisions by

Echlin or, in the alternative, rescission of the entire transaction. The domestic sales of carburetor kits of the acquired divisions (through APD and Ballwin/Washington) amounted to about 13% of the total sales of the five aftermarket divisions acquired by Echlin from Borg-Warner.

A. *The Product Market*

A carburetor kit is a kit or package containing those carburetor components which are most subject to wear and need replacement most often, plus some gaskets and gauges and an instruction sheet. Carburetor kits are used by automotive mechanics to repair or tune-up malfunctioning automotive carburetors which do not require carburetor replacement.

The 1980 total sales of carburetor kits in the United States were about $53 million at the wholesale level (to warehouse distributors). Ballwin/Washington, one of the acquired Borg-Warner divisions, manufactured carburetor parts and assembled and sold carburetor kits to about [***] national account customers, which sold the kits under their own brand names to the traditional warehouse dealer/jobber distribution channel. Ballwin/Washington also sold kits to APD, its sister division serving as Borg-Warner's principal aftermarket product marketing arm. APD sold kits to the warehouse-jobber channel in competition with other national account customers of Ballwin/Washington and kit assemblers.

Echlin purchased carburetor parts and assembled and sold carburetor kits to NAPA distribution centers. Echlin's kit sales accounted for less than 2% of Echlin's total U.S. sales of aftermarket products.

The complaint defines the relevant product market as "the assembly and sale of carburetor kits" (Comp. ¶ 3). Respondents' **[65]** attack on the alleged product market is twofold. First, respondents argue that carburetor parts and new and rebuilt carburetors are competitive products and belong in the same product market with carburetor kits. Second, they argue that carburetor kit "assembly" is a euphemism for a packaging function which lacks any economic significance and results in excluding from the product market competitive sources of kit supply, namely, some [***] private brand sellers of kits which do not "assemble" kits but sell purchased kits in competition with "assemblers." In my view, the evidence shows that the "assembly and sale of carburetor kits" is a valid product market in which to assess the competitive effect of the challenged acquisition.

Individually packaged carburetor parts can of course be used to tune-up a carburetor instead of using a kit containing these parts. They are functional substitutes and, in theory, they are interchangeable products. However, trade realities show that separately packaged parts are not practical substitutes for kits. The evidence shows that the availability of individually packaged carburetor parts are limited and their sales are *de minimis.* This is not surprising because carburetor kits came into their own by offering a convenient package which can be used to tune-up carburetors of different makes and models. Thus, individual parts do not belong in the same product market with kits. Also, sales of carburetor parts to warehouse dealers are *de minimis* and their inclusion or exclusion will not make any significant difference to the outcome of this case.

Replacement carburetors are functional substitutes for kits in the sense that a sluggish carburetor can always be replaced with a new or rebuilt carburetor instead of tuning up the old carburetor using a kit. However, kits are designed for use in carburetor tune-ups only and cannot be used when the carburetor malfunction is due to structural damages and requires carburetor replacement. Also, to the extent that replacement carburetors can be said to be functional substitutes of carburetor kits, replacement carburetors are much more expensive than kits and do not offer an economically reasonable alternative to kits, even when labor costs to the car owner are taken into consideration.

Most importantly, the evidence shows that there is no price sensitivity between replacement carburetors and carburetor kits, although the two product groups are generally regarded as competitive products. Therefore, new and rebuilt replacement carburetors are not close-enough substitutes for kits to be included in the same product market with carburetor kits.

Finally, whether it is called "assembly" or "packaging," the economic function that an assembler performs in creating a kit out of bulk components is essentially a production function, however simple. Furthermore, to suggest that a kit assembler does no more than package selected carburetor parts into a kit is to grossly mislead. A kit assembler's roles in developing and maintaining a line of kits from year to year and in providing the **[66]** many important marketing services to private brand customers (resellers) and to warehouse dealer/jobber customers are economically significant. These functions collectively set an assembler apart from a mere reseller and confer upon the assembler a degree of market power to which a reseller cannot aspire.

The evidence also shows that all of the leading kit assemblers, with the notable exception of Echlin (the third-ranking firm), fabricated in-house or on contract many of the key kit components, such as diaphragms, valves and needle-and-seat subassembly. However, all of the leading kit producers "sourced" other parts needed to make up kits and no firm, including the OE carburetor manufacturers, was completely self-sufficient. Rather, the economic significance of backward integration in the kit market appears to be that the more self-sufficient a firm is in parts, the greater is its control over kit production and product quality. In this sense, parts production capability is an important competitive advantage for a kit assembler. In sum, parts-fabrication is not an essential firm function in the production and sale of kits but assembly is. Therefore, the "assembly and sale of carburetor kits" is an appropriate product market for the purposes of this case.

B. *Market Share And Concentration Evidence*

In the measurement of market shares and market structure analysis, the administrative law judge adopted complaint counsel's methodology and included in Borg-Warner's kit sales the unit sales of both APD and Ballwin/Washington divisions.

It is true that Borg-Warner sold about [***] of kits it assembled (at Ballwin/Washington) to private brand sellers and other kit assemblers and sold the remaining [***] under the Borg-Warner name to the warehouse dealer/jobber channel of distribution through APD. However, it is settled that, once the product market is determined, as is the case here, it is appropriate for purposes of market share analysis to include in a firm's market share its sales to private brand sellers (or resellers). *See United States v. Black & Decker Mfg. Co.*, 430 F.Supp. 729, 737–38 (D. Md. 1976); *Beatrice Foods Co.*, 3 Trade Reg. Rep. (CCH) ¶ 22,035 at 22,624 (May 26, 1983); *Champion Spark Plug Co.*, D.9141, Initial Decision at 90 n. 10, adopted by the Commission (Final Order dated June 20, 1984) [103 F.T.C. at 623]. In the instant case, Borg-Warner's kit market share includes all kits it assembled and sold regardless of whether they are sold under the Borg-Warner label or not as long as the kits were marketed, either directly or through middlemen, to the same channels of aftermarket distribution. Borg-Warner likewise regarded its kit sales to resellers as a part of its "base market share" in the kit market. **[67]**

Prior to the acquisition, Borg-Warner was the top-ranking assembler and seller of carburetor kits and accounted for about 37.7% of the kit market in 1979 and 36.4% in 1980. Echlin was the third largest firm, accounting for about 10.1% in 1979 and 10.4% in 1980. As a result of the acquisition, Echlin became the top-ranking firm, with a *pro forma* 1980 share of about 46.8%.

The pre-acquisition four-firm concentration ratio of about 78.2% in 1979 increased to about 85.6% in 1980 on a *pro forma* basis. The Herfindahl-Hirschman Index ("HHI") increased from about 2,172 in 1980 to about 2,929 after the acquisition on a *pro forma* basis.

Thus, as a result of the acquisition, Echlin became by far the largest assembler and seller of kits and the acquisition further exacerbated the already high concentration in the carburetor kit market.

C. *The Effects Of The Acquisition*

Under established judicial and enforcement criteria, the resulting market shares of the acquisition and the degree of market concentration are so high that the acquisition will be a presumptive violation of the merger law and be prohibited unless it is shown that the market shares are not reliable indicia of the true competitive significance of the acquisition or that the market is likely to perform competitively regardless of the acquisition. *See* IV Areeda & Turner, Antitrust Law ¶¶ 909–912 at 29–68 (1980); Sullivan, Antitrust, Sections 204a and 204b at 613–21 (1977); *BASF Wyandotte Corp.*, 100 F.T.C. 261, 392 (Initial Decision dated May 14, 1982).

In the instant case, the administrative law judge will be guided by the 1982 *Statement of Federal Trade Commission Concerning Horizontal Mergers*, dated June 14, 1982 ("FTC Guidelines") and will also take into consideration the recently revised *Department of Justice Merger Guidelines* (June 14, 1984) ("DOJ Guidelines"). *Also see* Clanton, *Focusing the Inquiry: Specificity In The Merger Guidelines and Elsewhere*, 71 Calif. L. Rev. 430, 433–36 (1983); Greenfield, *Beyond Herfindahl: Non-Structural Elements of Merger Analysis*, 53 Antitrust Law J. 299 (1984).

The 1982 FTC Guidelines indicated the Commission's view that, while market share data remain "an important indicium of the likely competitive effects of a merger," it will employ "a more refined treatment" of such data in light of "more recent empirical economic research and well over a decade of practical experience in analyzing and evaluating horizontal mergers" and give greater consideration to non-market share evidence, the most important of which being that of entry barriers. *See FTC Guidelines* at 2–3. **[68]**

In the instant case, several important factors diminish the significance of market shares as a surrogate measure of the merging firms' market power. *First*, although new and rebuilt carburetors are not close-enough substitutes for carburetor kits to be included in the same market with kits, they are generally competitive products and rebuilt carburetors will have a significant restraining influence upon the market power of the resulting firm (Echlin). *See* Greenfield, *Beyond Herfindahl: Non-Structural Elements of Merger Analysis*, 53 Antitrust Law J. 299 (1984).

Secondly, the power of kit assemblers to control the product quality, price or output in the kit market is limited. Although the kit sales of an assembler to private brand sellers (or resellers) were included in the assembler's sales for the purpose of market share analysis, the evidence is clear that the resellers, [***] are generally able to pursue substantially independent competitive strategies with respect to product quality and price in competition with kit assemblers.

Thirdly, and perhaps most importantly, entry barriers are virtually non-existent or very low. Although there has been only one substantial entry during the past decade, there has been other smaller entries. In any event, the paucity of new entrants do not necessarily show high entry barriers. *Grand Union Co.*, D. 9121 (July 18, 1983) at slip op. 46 [102 F.T.C. at 1063]. Rather, when viewed against the evidence showing low entry barriers, the record is consistent with the view that paucity of new entry into the assembly of kits may be due to the relatively small size of the market (1980 sales of about $53 million) and the presence of some ten assemblers in the market, as well as to the sufficiently attractive profit opportunities enjoyed by private brand sellers of purchased kits.

In my view, these factors clearly show that there are important factors at work to limit the exercise and the duration of the market power by the leading firms in the kit market and that the market shares are not reliable indicators of the true competitive significance of the acquisition.

Furthermore, several elements in the non-market share phase of the kit market suggest that the industry has performed in a fashion consistent with competition and is likely to do so in the future.

Although the evidence does not show a vigorous price competition, a lively competition is waged in terms of product innovation and improvement as well as in a wide range of customer services. Also, there is no credible evidence to conclude that the leading firms have enjoyed supra-competitive profits in recent years. And the record shows that smaller firms, albeit small in number, are profitable and able to grow. **[69]**

Finally, due to recent incorporation of the throttle body injection ("TBI") system (in the place of conventional carburetors) in increasing numbers of new cars, the carburetor kit market is undergoing a radical technological change and faces a gradual decline in the next ten years. In the meantime, there is reason to believe that as the number of imported cars increases so will competition from imported carburetor kits.

Therefore, it is concluded that complaint counsel have failed to show by a preponderance of credible evidence that the effect of the challenged acquisition is likely to lessen competition substantially in the assembly and sale of carburetor kits.

CONCLUSIONS OF LAW

1. The Federal Trade Commission has jurisdiction over the respondents and the subject matter of this proceeding.

2. Respondent Echlin Inc. ("Echlin") is a Connecticut corporation with its headquarters in Branford, Connecticut.

3. Respondent Borg-Warner Corporation ("Borg-Warner") is a Delaware corporation with its principal office in Chicago, Illinois.

4. At all times relevant to this proceeding, respondents were engaged in commerce, or their acts and practices were in or affecting commerce, as "commerce" is defined in the Clayton Act, as amended, and in the Federal Trade Commission Act, as amended.

5. The appropriate product market within which to evaluate the competitive effects of the acquisition of Borg-Warner's automotive aftermarket assets by Echlin is the assembly and sale of carburetor kits (carburetor kit market).

6. The appropriate geographic market within which to evaluate the competitive effects of that acquisition is the United States as a whole.

7. The carburetor kit market is highly concentrated.

8. In 1980, Borg-Warner accounted for about 36.4% and Echlin, for 10.4%, of the carburetor kit market.

9. The acquisition produced a top-ranking firm with a combined 1980 share of 46.8% on a *pro forma* basis, and the anticompetitive potential of the acquisition is substantial.

10. The acquisition eliminated the direct competition between Echlin and Borg-Warner. **[70]**

11. The record evidence concerning various non-market share factors and market performance is sufficient to overcome the substantial anticompetitive potential of the acquisition inferred from market share evidence alone. Such factors include the following, among others:

(a) Substitute products, such as new and rebuilt replacement carburetors, compete with carburetor kits;

(b) A large number ([***]) of resellers of kits (private brand sellers of purchased kits) compete with kit assemblers;

(c) The power of kit assemblers to control competition in the kit market is significantly limited;

(d) Entry barriers into the assembly and sale of kits are very low;

(e) The kit market is undergoing a radical technological change;

(f) The kit market is likely to face increasing import competition.

(g) There is lively competition in terms of product innovation and improvement as well as a wide range of customer services provided by the kit assemblers, although a vigorous price competition is not evident.

(h) The evidence does not show that the market is characterized by supra-competitive profit levels over time;

(i) The smaller kit assemblers are profitable and appear to be able to grow.

12. Complaint counsel have failed to establish, by a preponderance of credible evidence, that the acquisition by Echlin of Borg-Warner's automotive aftermarket assets is a violation of Section 7 of the Clayton Act or Section 5 of the Federal Trade Commission Act, as amended, as alleged in the complaint.

Accordingly, the following order will be entered. **[71]**

ORDER

It is ordered, That the complaint be, and the same hereby is, dismissed.

OPINION OF THE COMMISSION

BY DOUGLAS, *Commissioner:*

The complaint in this matter alleges that respondents The Echlin Manufacturing Company and Borg-Warner Corporation have violated Section 7 of the Clayton Act, 15 U.S.C. 18 (1982), and Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45 (1982).[1] The alleged offense is Echlin's acquisition of Borg-Warner's automotive aftermarket operations, which manufacture, assemble, and sell automotive parts that are used to replace original equipment on automobiles. This acquisition is said to have posed a likelihood of substantially lessening competition in the assembly and sale of carburetor kits.

ALJ Montgomery K. Hyun issued his initial decision on September 14, 1984. He found that the allegations of the complaint had not been proved and therefore ordered that the complaint be dismissed. Complaint counsel appeals that decision; **[2]** respondent Echlin also appeals and urges the Commission to "correct" several of the ALJ's findings. No appeal was filed by or with regard to respondent Borg-Warner.

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[1] In the remainder of this opinion, the following short forms and abbreviations will be used:

I.D.F. - Initial Decision Finding of Fact No.
CX - Complaint Counsel's Exhibit No
ALJ The Administrative Law Judge
Echlin - The Echlin Manufacturing Company
Borg-Warner - Borg-Warner Corporation
Sherman - Sherman Carburetor Company
Carter - Carter Automotive Division of ACF Industries, Inc.
FTC Statement - FTC Statement on Horizontal Mergers (June 14, 1982)
DOJ Guidelines - Justice Department Merger Guidelines (June 14, 1984)

Transcript citations will be given as the last name of the witness and the page on which the testimony appears.

We affirm. The ALJ conducted an exhaustive analysis of the relevant product market, various quantitative measures of concentration, and a number of qualitative considerations bearing on the likelihood of anticompetitive effects caused by the acquisition. We will not address all the issues resolved in the initial decision or raised by the parties on appeal because we have determined that there are no barriers to entry into the assembly and sale of carburetor kits. In the absence of entry barriers, there can be no anticompetitive effect from the acquisition, and no violation of the antitrust laws.

This Opinion begins with a brief summary of the relevant facts. We will then outline the analytical framework within which these facts must be viewed, including the significance of barriers to entry and a description of those industry characteristics that can constitute entry barriers. Finally, we will apply that framework to the facts of this case to determine whether the assembly and sale of carburetor kits is characterized by significant barriers to entry that could permit the exercise of market power.

I. THE ASSEMBLY AND SALE OF CARBURETOR KITS

A carburetor kit is a collection of parts that can be used to "tune up" a defective carburetor and return it to optimal performance. It consists of those parts that are most likely to be in need of replacement. I.D.F. 58–68. A given kit may be [3] designed for only a single carburetor model, or it may contain alternative parts that enable it to be used for any one of several models. I.D.F. 127, 130–36.

The carburetor kit industry includes manufacturers of the parts that are used in the kits, assemblers of the kits themselves, and resellers who purchase kits from some assemblers. These functions, while theoretically distinct, frequently overlap in practice. The individual carburetor parts that are contained in kits are manufactured by many companies and can be obtained with relative ease. I.D.F. 121, 221; Sheehan 585; Jursek 732–36, 810–11; Thompson 2454–55; Carlson 2554–55; Bush 2863–77; Schultz 3040–45; Timberlake 3080–83; Smith 3178–82.[2] Most assemblers of carburetor kits manufacture at least some of the parts used in their kits; before its acquisition of Borg-Warner, Echlin was the only major exception to this rule. I.D.F. 3, 121, 124. Nonetheless, no major assembler manufactures all the parts used in its kits. *See* I.D.F. 118, 175–88. Most assemblers also buy some kits from other assemblers to fill out their lines. I.D.F. 118,

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[2] The only arguably contrary testimony was given by a witness who admittedly was never involved in the economics of acquiring parts, but who nonetheless was able to identify several alternative sources for various carburetor parts. Insalaco 910–15, 974–88.

175–90. At the extreme end of this continuum are about forty resellers of carburetor kits, who buy all their kits from assemblers, but sell them under their own labels. I.D.F. 150–55, 195. [**4**]

Assembled carburetor kits are generally sold to wholesaler-distributors, who sell them to jobbers, who in turn sell them to the ultimate users, automobile mechanics. I.D.F. 142–45. Some kits are sold to automobile dealerships for use in their service facilities. I.D.F. 146–48. A very few kits are sold to the public through mass merchandisers. I.D.F. 149. In 1980 approximately 13 million carburetor kits were sold to wholesaler-distributors for about $53 million. I.D.F. 174, 230. The parties are in agreement that the market for carburetor kits is likely to remain stable or to decline through the 1980s. *See* I.D.F. 77.

At the time of Echlin's acquisition of Borg-Warner, Borg-Warner was easily the nation's largest assembler of carburetor kits. Through its Ballwin/Washington Division, it manufactured carburetor parts, some of which were sold to carburetor rebuilders and other kit assemblers, and assembled carburetor kits, which were sold to resellers, to other assemblers, and through its Automotive Parts Division, to wholesaler-distributors. I.D.F. 14–23, 31–47, 175–76. Other large kit assemblers included Echlin, Standard Motor Products, Inc., General Motors Corporation (through its Rochester Division and AC-Delco marketing organization), ACF Industries, Inc. (through its Carter Automotive Division), Tomco, Inc., and Colt Industries Operating Corporation (through its Holley Replacement Parts Division). I.D.F. 1–13, 177–88. Finally, there were a few very small domestic and foreign assemblers. I.D.F. 189–93. [**5**]

Two former assemblers, Ford Motor Company and Carter, have stopped assembling carburetor kits and now function solely as resellers. I.D.F. 152, 253; Lingle 3511–18, 3521, 3525–26. In 1980 Ford accounted for about six percent of kit sales to wholesaler-distributors, while Carter, which had not yet ceased assembling kits, assembled about seven percent of all kits; no other reseller sold more than three percent of all kits. I.D.F. 183; CX 464 [in camera]; CX 530. About seventy percent of Borg-Warner's sales of carburetor kits were to resellers or other assemblers. I.D.F. 151, 295. Resellers of carburetor kits include Carter, Ford Motor Company, Chrysler Corporation, American Motors Corporation, Volkswagen of North America, Subaru, Wells, and divisions of TRW and Gulf & Western. Merz 2749–61; CX 464 [in camera]. Many resellers participate in the design of their line of carburetor kits. *See* Baumann 1013–23, 1033–36, 1041–44; Secrest 1127–28; Carlson 2552–53; Merz 2724–26; Rivet 2836–39; Eaton 2946–49; Lingle 3518–21; Lehman 5016–19. Many also have established distribution systems. Nelson 1963–65. And at least some resellers already possess the physical facilities needed to assemble carburetor kits. *See* Baumann 1037–39. Others who do not presently assemble kits perceive little difficulty in entering the market. I.D.F. 272; Brown 3387–90; Bull 3675–77; *see* Willig 4737–44.

The physical assembly of carburetor kits is a simple manual process. In essence, it involves placing the right carburetor parts into the right boxes. I.D.F. 78–79, 220. This can be facilitated by the use of a conveyor belt or a "lazy-Susan-like" **[6]** tray. I.D.F. 79–81. The ALJ visited the production facilities of one assembler and "was impressed by the simplicity of the process which appeared neither elaborate nor complex." I.D.F. 82. The capital investment required to begin assembling kits is not large, Nelson 2323, and consists mainly of equipment that could be used for other purposes, Willig 4778–85. One recent small-scale entrant started by assembling kits in his home. His out-of-pocket cost was about five hundred dollars, which paid for "a local carpenter [to] come in and put up tables, hang new lights so they could see better. I would say that plus buying shelving from a local hardware store that went out of business." Although his company's market share remains very low, he testified that it was successful. Carlson 2558–63.

In recent years, at least two foreign and two domestic firms have made small-scale entries into the assembly of carburetor kits for sale in the United States. The two foreign firms are Japanese automobile manufacturers; the two domestic firms began as resellers and expanded into kit assembly. I.D.F. 237–39, 258–71. The ALJ found that the small kit assemblers "are profitable and appear to be able to grow." I.D.F. 292.

In early 1981 Sherman Carburetor Company, a manufacturer of carburetor parts, began to consider assembling kits. Insalaco 920, 926–28, 965–66. Sherman made the decision to enter the kit market in November 1981, Insalaco 888, and first solicited sales the following month, Insalaco 929. Its first sale came in February 1982, only three months after it made the decision to enter the market. I.D.F. 246. Within two years, Sherman had **[7]** made sales to most of the resellers, although its market share continued to be small. I.D.F. 247, 252. There is no evidence that Sherman's relatively low level of sales resulted from anything other than its potential customers' preference for Echlin at prevailing prices.[3] When Carter stopped assembling kits, it chose Sherman as its supplier. Sherman was able to expand its operations to supply the additional kits to Carter. Insalaco 983–84, 987–88. It was expected that Carter would be buying all its kits from Sherman within six to nine months; the delay was designed in part to allow Carter to exhaust its existing inventories. I.D.F. 253; Sheehan 536–37; Eaton 2957; Lehman 5023–24, 5037–38. [8]

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[3] The ALJ found that Sherman was handicapped by its lack of a full line and its "inability" to offer marketing services, such as catalogs and promotional aids. I.D.F. 257; *see* I.D.F. 128, 224. The need to offer a full line only applies, if at all, to sales to wholesaler-distributors; the evidence is clear that resellers and other assemblers could, and often did, buy less than a full line. *See* I.D.F. 118, 128, 177–89, 247–51, 253. Moreover, the need to offer a full line is not the same as the need to assemble a full line. Like most assemblers, Sherman could have purchased additional kits to fill out its line. The need to offer marketing aids would also not apply to resellers, who are already in the business of marketing carburetor kits, and many of whom prepare their own catalogs. I.D.F. 245; Baumann 1020–21, 1036; Stefan 2672; Kruse 2926; Castagna 3744–46. Sherman was fully capable of preparing catalogs and

(footnote cont'd)

Complaint counsel maintains that Echlin, which had already acquired Borg-Warner's production facilities for carburetor parts and kits, took various actions in retaliation for Sherman's entry into kit assembling. One witness testified that Echlin threatened to cut off the supply of parts to Sherman. I.D.F. 254; Insalaco 932–34, 975–76. Another witness claimed that Echlin threatened to withhold its catalog from Carter and stated that Echlin would address its supplying of parts to Sherman at a later date. Lehman 5027–43. Nonetheless, Sherman continued to buy parts from Echlin, and Carter continued to receive catalogs. I.D.F. 254; Insalaco 966–67; Lehman 5033–36, 5042–43. Finally, when Sherman tried to attract Echlin's customers with lower prices, Echlin reduced some of its prices. I.D.F. 255.

II. THE ANALYTICAL FRAMEWORK

A. *The Significance of Barriers to Entry*

Section 7 of the Clayton Act prohibits acquisitions that may have the effect of substantially lessening competition or tending to create a monopoly. Because Section 7 applies to "incipient" violations, actual anticompetitive effects need not be shown; an acquisition is unlawful if such an effect is reasonably probable. *E.g., American Medical International, Inc.*, No. 9158, slip op. at 17–18 (July 2, 1984) [104 F.T.C. 1].

Traditionally, an analysis under Section 7 begins with the definition of a relevant market and measurement of the concentration in that market. *See generally* FTC Statement Sections III, VI; DOJ Guidelines Sections 2, 3.11. This approach by itself is unsatisfactory, however, because it fails to reflect many factors [9] that can determine whether a merger is likely to lessen competition substantially by enabling one or more sellers to impose higher prices than would prevail under competitive conditions. *See Grand Union Co.*, 102 F.T.C. 812, 1038–41 (1983). Therefore, the Commission also looks to other considerations that bear on the likelihood of anticompetitive effects. *See generally* FTC Statement Section III; DOJ Guidelines Sections 3.21 to 3.45. These additional considerations often do not lend them-

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other promotional aids if it so desired. *See* Insalaco 965; Carlson 2560–61; Stefan 2669–72; Merz 2737; Kruse 2922–29. Rather, Sherman made a conscious decision to offer a short line without promotional assistance, at a low price, as a competitive gambit. *See* I.D.F. 243–44. If this strategy failed, it was only because potential buyers preferred Echlin's product, price, and mix of services to those offered by Sherman. *See* I.D.F. 225; *cf. United States v. Waste Management, Inc.*, 743 F.2d 976, 984 (2d Cir. 1984) (goodwill earned by incumbent firm is not barrier to entry).

selves to precise mathematical expression, but they can be more important than quantitative measures of concentration. *See American Medical International, Inc.*, No. 9158, slip op. at 27 (July 2, 1984) [104 F.T.C. 1].

The most important of these considerations is the existence of barriers to entry. *See Grand Union Co.*, 102 F.T.C. 812, 1063 (1983); FTC Statement Section III (A)(1). On the one hand, an absolute barrier to entry, such as a governmental prohibition or an essential but unobtainable natural resource, supports the original market definition by confirming that no new supply would enter the market even if prices were increased significantly above the competitive level. On the other hand, if there are literally no barriers to entry, the original market definition loses any economic significance. An attempt to exercise market power in an industry without entry barriers would cause new competitors to enter the market. This additional supply would drive prices back to the competitive level. Indeed, the threat of new entry can be as potent a procompetitive force as its realization. As the Supreme Court has recognized, the presence [10] of potential entrants on the fringe of a market can prevent the exercise of market power by the incumbent firms even if the potential entrants never actually enter the market. *See United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 533 (1973); *Ford Motor Co. v. United States*, 405 U.S. 562, 567–68 (1972); *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 580–81 (1967); *United States v. Penn-Olin Chemical Co.*, 378 U.S. 158, 173–74 (1964); *see also B.A.T Industries, Ltd.*, No. 9135, slip op. at 6–7 (Dec. 17, 1984) [104 F.T.C. 1154]. Thus, in the absence of barriers to entry, incumbent firms cannot exercise market power, regardless of the concentration in the nominal "market," and indeed even if that "market" has been "monopolized" by a single firm. *See United States v. Waste Management, Inc.*, 743 F.2d 976, 981–84 (2d Cir. 1984); *Grand Union Co.*, 102 F.T.C. 812, 1063 (1983); FTC Statement Section III-(A)(1); DOJ Guidelines Section 3.3; W. Baumol, J. Panzar & R. Willig, *Contestable Markets and the Theory of Industry Structure* 12, 350 (1982); F. Scherer, *Industrial Market Structure and Economic Performance* 11 (2d ed. 1980); 2 P. Areeda & D. Turner, *Antitrust Law* ¶ 505 (1978); J. Bain, *Barriers to New Competition* 3–4 (1956); Ordover & Willig, *The 1982 Department of Justice Merger Guidelines: An Economic Assessment*, 71 Calif. L. [11] Rev. 535, 555, 563 (1983); Baumol & Willig, *Fixed Costs, Sunk Costs, Entry Barriers and the Sustainability of Monopoly*, 96 Q.J. Econ. 405, 411 (1981); Landes & Posner, *Market Power in Antitrust Cases*, 94 Harv. L. Rev. 937, 950 (1980).[4]

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[4] In *American Brake Shoe Co.*, 73 F.T.C. 610 (1968), the Commission stated that "the finding that entry into a market is difficult is not indispensable to the finding of illegality under § 7." *Id.* at 684. In that case, however, the Commission also noted several industry characteristics that could delay entry for several years. *Id.* at 683; *see also Ekco Products Co.*, 65 F.T.C. 1163, 1208 (1964) (explaining that ease of entry could not overcome Section 7 illegality

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B. *The Nature of Barriers to Entry*

This conclusion requires us to address the nature of barriers to entry. Under Section 7 of the Clayton Act, the focus must be on industry characteristics that would allow incumbent firms to reap monopoly profits for a significant period of time.

Complaint counsel suggests that entry barriers are high whenever it is unlikely that new firms will decide to enter the market. We cannot agree. Although high barriers indicate that entry is unlikely, reversing that statement goes too far. For example, entry would be most unlikely if all the incumbent firms were losing money, yet this is clearly not the kind of barrier that facilitates the extraction of monopoly profits. *See* 2 P. Areeda & D. Turner, *Antitrust Law* ¶ 409b (1978). The likelihood of entry may be influenced by general business conditions, the **[12]** potential return on alternative uses of capital, or the inherent riskiness of the industry. But although these factors may be relevant to an estimate of the competitive price level in an industry and thus to the likelihood of entry at any given time, they do not make it more or less likely that incumbent firms will be able to exceed the competitive price level and charge monopoly prices. Regardless of the exact price level that competition should dictate in an industry, which will depend in part on the factors cited above, prices above that level will create a strong inducement to potential entrants and make new entry more likely. *Cf.* DOJ Guidelines Section 3.3 (referring to "likelihood" of entry in response to price increase).

Respondents propose that an entry barrier be defined as additional long-run costs that must be incurred by an entrant relative to the long-run costs faced by incumbent firms. This definition is now widely accepted in the legal and economic communities. *See* G. Stigler, *The Organization of Industry* 67 (1968); *see also* Nelson 1531–32, 1654–58, 1935; Glassman 4214; Willig 4746–47; 4 E. Kintner, *Federal Antitrust Law* § 37.4 (1984); 2 P. Areeda & D. Turner, *Antitrust Law* ¶ 409a (1978); R. Posner, *Antitrust Law: An Economic Perspective* 59 (1976); Baumol & Willig, *Fixed Costs, Sunk Costs, Entry Barriers and the Sustainability of Monopoly*, 96 Q.J. Econ. 405, 408 (1981). The rationale underlying this definition is that low-cost incumbent firms can keep prices above the competitive level as long as those prices remain below the level that would provide an incentive to higher-cost potential entrants. Thus, a long-run **[13]** cost differential could erect

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because new entry "is likely to be at best a long-term affair"), *aff'd*, 347 F.2d 745 (7th Cir. 1965). Because our understanding of barriers to entry, set forth below, encompasses significant delays encountered by entrants, it does not depart from these earlier cases. To the extent that these cases may be read as implying that a violation of Section 7 can be found in the absence even of a significant delay in entry, they are inconsistent with more recent legal and economic developments, which are reflected in the materials cited above.

a permanent barrier to new entry that would allow the maintenance of supracompetitive profits for an indefinite period of time.

This definition offers a good framework for our analysis of the likelihood that an acquisition will substantially lessen competition. If, for example, potential entrants face an absolute governmental prohibition on entry, their costs would obviously exceed the costs of the incumbent firms. On a less extreme level, an entry barrier might exist if the incumbent firms possess patents that enable them to operate with substantially lower costs than an entrant who could not duplicate the patents or achieve the same results by any other means.

It should be noted, however, that a definition of entry barriers in terms of costs can be misleading. The relevant costs are economic costs measured at the time of entry. No barrier to entry is created, for example, if inflation increases the cost of a factor of production so that entrants must pay a higher nominal price than was paid by incumbents when they acquired their productive capacity. The economic cost to incumbents is the opportunity cost of retaining a factor of production, not the original price that was paid for it. Likewise, costs must be viewed from the same temporal vantage point for all firms. For example, the act of entering a market may involve a high risk that declines sharply after the successful entry has been made. If one were to compare the risk faced by a potential entrant with the current risk confronting an incumbent firm, it would appear that the incumbent has a decided risk advantage and thus a lower [14] cost of capital. This is not a proper comparison. The incumbent firm's apparently lower costs merely reflect compensation for the risk it incurred in entering the market. The potential entrant's apparently higher costs will decline to that of the incumbent firm if its attempted entry is successful. The only meaningful way to compare the risks and costs incurred by the two firms is to apply the same yardstick to each by viewing each of them at the time of its own entry.

Unless there is a barrier to entry, as defined above, market power cannot be exercised indefinitely. Sooner or later, new firms will enter the market and drive prices back down to competitive levels. From the standpoint of the public, however, it makes a great deal of difference whether this occurs sooner or later. There may be little practical difference between an absolute barrier to entry and conditions of entry that delay the restoration of competitive prices for decades.

Therefore, we will also consider a second type of barrier to entry, which might more accurately be called an impediment to entry. An impediment to entry is any condition that necessarily delays entry into a market for a significant period of time and thus allows market power to be exercised in the interim. "To be sure, merger analysis properly focuses primarily on long-term competitive implications, but short-term effects should not be ignored, particularly if they are substantial." FTC Statement Section III(A)(1); *see also* 2 P. Areeda & D. Turner, *Antitrust Law* ¶¶ 409a, 505 (1978); R. Bork, *The Antitrust Paradox* 311 (1978); R. Posner, *Antitrust Law: An Economic Perspective* 58–59 (1976); *cf.* DOJ Guidelines Section 3.3 (two-year test); Easterbrook, *Limits of* **[15]** *Antitrust,* 63 Texas L. Rev. 1, 32–33 (1984) (five-year test). For example, if entry into an industry is only possible by constructing a physical plant that cannot be completed in less than a decade, that industry would appear to be characterized by a high barrier to entry for purposes of our analysis under Section 7. Once again, the inquiry must focus on industry characteristics that permit incumbent firms to earn monopoly profits, not on characteristics that increase risk or decrease profitability for all firms and thus affect the competitive rate of return for the industry as a whole.

III. THE EFFECT ON COMPETITION

As explained above, an acquisition is not likely to have substantial anticompetitive effects if the evidence shows that there are no barriers to entry, regardless of the level of concentration that is present in the relevant market. For purposes of discussion, therefore, we will assume that the ALJ was correct in adopting the relevant product market advanced by complaint counsel, which is the assembly and sale of carburetor kits.[5] **[16]**

Complaint counsel identifies four alleged market characteristics as potential barriers to entry: Sunk costs, economies of scale, recent history, and predatory practices. We reject each of these arguments and agree with the ALJ's conclusion that entry into this industry is "rather easy" and that entry barriers are "virtually nonexistent" or "very low." I.D.F. 216, 273, 296. The evidence shows that there are no barriers to entry into the assembly and sale of carbureter kits and no impediments to entry that would delay entry for a significant time. Because this finding eliminates any possibility that the acquisition may have a substantial anticompetitive effect, we affirm the ALJ's initial decision dismissing the complaint.

Complaint counsel first maintains that entry into the assembly and sale of carburetor kits requires a significant investment to design a line of kits, purchase equipment, build an inventory of kits and parts, and introduce the new line. These costs, according to complaint counsel, are sunk costs because they would be unrecovered or only partially recovered if entry were unsuccessful. The presence of sunk costs thus imposes an additional risk on a potential entrant and requires it to demand a higher–than–normal rate of return before making the investment. Because the required rate of return is an economic costs, potential entrants would face higher costs than the incumbent firms.

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[5] We also assume without deciding that complaint counsel has satisfied the initial burden of offering evidence sufficient to make out a prima facie case of liability. When resolution of one issue may make it unnecessary to undertake a complex and time-consuming analysis of other issues, the Commission will often consider that issue first. *See International Telephone & Telegraph Corp.*, No. 9000, slip op. at 29–30 (July 25, 1984) [104 F.T.C. 280]. In this case, the absence of barriers to entry is just such an issue.

This argument fails for several reasons. First, as the ALJ concluded, the evidence shows that these costs are insignificant. *See* I.D.F. 226, 233–35. Second, we note that one [17] class of potential entrants, resellers, would not incur many of these costs because they already have kit designs, an inventory of kits, and a distribution system. Moreover, as complaint counsel concedes, an investment in equipment to facilitate the assembly of kits would not be a sunk cost because the same equipment can be used for other purposes. Third, there is some doubt whether sunk costs, standing alone, should be viewed as a barrier to entry at all. *See* Glassman 4240–41; Willig 4785. If sunk costs are considered an entry barrier, it must be because they create a difference in the risk confronting the incumbent firms who have already committed their resources and potential entrants who have yet to make that decision. *See* Nelson 1575–81; Willig 4775–78; Baumol & Willig, *Fixed Costs, Sunk Costs, Entry Barriers and the Sustainability of Monopoly,* 96 Q.J. Econ. 405, 418–19 (1981). This, however, is a false comparison, because the returns earned by the incumbent firms reflect in part the risks they faced at the time they made the decision to enter the market. In any event, the evidence indicates that a potential assembler of carburetor kits would run risks that are no higher than those faced by past entrants, who are the present incumbents. I.D.F. 272; Glassman 4240–49.

Complaint counsel next argues that economies of scale create a barrier to entry. This is especially true, complaint counsel maintains, because the market for carburetor kits is small and may decline in the future. Under this theory, a potential entrant will recognize that its entry is only feasible on a scale that would create excess capacity in the industry and thus [18] depress prices. This potential for excess capacity and falling prices increases the risk of entry and the required rate of return.

We agree with the ALJ's conclusion that there are no substantial economies of scale in this industry. *See* I.D.F. 227–32. In fact, all but two of the firms operating after the merger are doing so at a level that is lower than the "minimum efficient scale" urged by complaint counsel, which is ten percent of the market; several firms operate with two percent of the market or less. I.D.F. 189–92.[6] Thus, if the smaller firms do suffer a cost disadvantage, it does not reach a level that would raise substantial competitive concerns. Moreover, a reseller intending to enter the market would have a significant head start on the necessary market share, even assuming that such a thing exists, because it could begin by assembling kits for its own use. Finally, we cannot agree that economies of scale and declining markets necessarily create barriers to entry. They may increase the risk of participating in this industry and thus the competitive rate of return required by all participants, but they **[19]** do not impose a risk or cost on potential entrants that was not borne equally by the incumbent firms. *See* 2 P. Areeda & D. Turner, *Antitrust Law* ¶ 409b (1978); R. Bork, *The Antitrust Paradox* 311 (1978); R. Posner, *Antitrust Law: An Economic Perspective* 92 (1976); G. Stigler, *The Organization of Industry* 67 (1968). *But see* Nelson 1581–83, 1657–60; DOJ Guidelines Section 3.3 n.21.[7]

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[6] Complaint counsel's expert witness testified that these companies are able to survive only because the existing price level is above the competitive level and thus creates a "price umbrella" sheltering the smaller competitors from their alleged cost disadvantage. Nelson 2242–44, 2255–56. This position was properly rejected by the ALJ on the ground that there is no credible evidence that kit assemblers have earned supracompetitive profits. I.D.F. 288–91. Complaint counsel's argument is also inconsistent with the decisions by Ford Motor Company and Carter

(footnote cont'd)

Complaint counsel also looks to the historical record, which is characterized as devoid of successful entry into the market. The paucity of past entry is claimed to evidence high barriers. *See* FTC Statement Section III(A)(1). The absence of past entry, however, does not prove the existence of entry barriers because it is equally consistent with alternative explanations, such as a declining industry or competitive prices. I.D.F. 273; *United States v. Waste Management, Inc.*, 743 F.2d 976, 983 (2d Cir. 1984); *Grand Union Co.*, 102 F.T.C. 812, 1064 (1983); Baumol, *Contestable Markets: An Uprising in the Theory of Industry Structure*, 72 Am. Econ. Rev. 1, 14 (1982). Obviously, it would be absurd to infer the presence of entry barriers and a potential for supracompetitive profits from evidence that is equally consistent with competitive or subcompetitive profits.

In fact, the historical record refutes the allegations of barriers to entry in this industry. The critical facts do not concern the frequency of entry so much as the manner, ease, and rapidity of the entry that has occurred. Five companies have **[20]** entered the market in the last decade. All five companies continue to operate despite the fact that four of them have market shares that are extremely small. One company began operations with an out-of-pocket investment of only five hundred dollars. The largest recent entrant, Sherman, sold its first kit only three months after making the decision to begin assembling kits. When Carter later decided to buy its kits from Sherman instead of assembling them, Sherman was able to expand within six to nine months to meet the substantial new demand, and part of this delay was due to Carter's decision to exhaust its inventories before purchas-

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to cease assembling carburetor kits. If price levels were so far above the competitive norm that even very small firms were profitable despite the allegedly high economies of scale, it is difficult to see why these two relatively large assemblers found it more profitable to buy their kits from others. *See* I.D.F. 152.

[7] In particular, the risk of excess capacity is borne by all firms, whether they entered the market recently or long ago, because any firm could lose market share in the event of excess supply or insufficient demand.

ing all its kits from Sherman.[8] Thus, the experience of Sherman demonstrates that if prices were ever raised above competitive levels, a future entrant could become a major assembler of carburetor kits in less than a year, even if it is assumed that Sherman's entry and expansion were delayed solely by conditions of entry. Moreover, Sherman was in no better position to enter the market, and in many ways was in a worse position, than many resellers of carburetor kits, who are poised at the edge of the market in a position to begin assembling kits on short notice with only a minor investment. We **[21]** conclude that nothing in this record suggests that entry barriers would allow the incumbent firms to maintain supracompetitive prices for any meaningful period of time.

Finally, complaint counsel argues that the risk of retaliatory actions by the incumbent firms against entrants is a substantial deterrent to new entry. This theory postulates that potential entrants, unlike the incumbent firms, risk arousing the wrath of the present assemblers, who can undermine an entrant's profits through below-cost pricing and other predatory devices. Recognizing this additional risk, the entrant would require expected profits that exceed the competitive level before committing itself to entry. The existence of this margin between competitive prices and prices sufficient to trigger entry would allow the incumbent firms to exercise market power.

This argument fails for two reasons. Retaliatory price-cutting and other predatory practices are unlikely to deter entry unless there is a significant barrier to entry in addition to the mere threat of retaliation. If there is not such entry barrier, the incumbent firms will never be able to raise prices above the competitive level without attracting entry, and therefore they will never be able to recoup the losses they suffered by selling their products below costs. 3 P. Areeda & D. Turner, *Antitrust Law* ¶ 711b (1978); *see International Telephone & Telegraph Corp.*, No. 9000, slip op. at 37, 43–44 (July 25, 1984) [104 F.T.C. 359]. We have found no such additional barrier, so any threat of retaliation in this industry would be unlikely to be effective and hence would not be credible. **[22]**

Moreover, the evidence does not reveal that retaliatory actions have taken place in the past or will take place in the future. The first alleged retaliatory act was a threatened refusal by Echlin to sell parts to Sherman after Sherman began assembling kits. The only evidence of such a threat is the hearsay testimony of an independent sales representative of Sherman, who said that Sherman's owner told him that an unidentified person associated with Echlin threatened to stop selling parts to Sherman. No party offered testimony from anyone with first-hand knowledge of the conversation in question. Unlike a federal court, an administrative agency may receive hearsay into evidence, but hearsay is not thereby entitled to the same evidentiary force as testimony based on the first-hand knowledge of the witness. Under the circumstances of this case, we believe it is entitled to no weight at all. In fact, notwithstanding the alleged threat, Sherman did enter the market and continued to buy parts from Echlin. And even if the alleged threat had materialized, the record is clear that Sherman had access to many other potential suppliers. We cannot conclude from this record that there was a threat, that it would have been credible, or that it had or could have had any effect on competition.

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[8] Complaint counsel asserts that the presence of barriers to entry is demonstrated by Sherman's low market share after two years of assembling kits. The evidence, however, reveals that Sherman's low market share was attributable to its difficulty in selling kits in competition with other assemblers, and not to any impediment that prevented it from producing kits. *See* n.3 *supra*. Of course, if other assemblers were charging supracompetitive prices, demand for competitively priced kits would increase, and a company like Sherman would be limited in its effect on the market only to the extent that entry barriers hindered its efforts to assemble enough kits to meet that demand.

The second allegation of retaliation is that an Echlin employee threatened to stop providing Carter with catalogs after Carter decided to buy its kits from Sherman and told Carter that Echlin would address its sales of parts to Sherman at a later date. Withholding a catalog is hardly a threat sufficient to deter entry, since catalogs were widely distributed and readily **[23]** available from other sources. Lehman 5046–47; *see* Fife 626; Nelson 1980; Thompson 2452. The statement regarding the supplying of parts is not even an explicit threat, and even if it were, a threat to withhold parts would not be credible because of the presence of alternative suppliers. Since Echlin continued to supply catalogs to Carter and parts to Sherman, and since Sherman was not deterred from entering the market, we will not infer the existence of a barrier to entry from this weak and ambiguous evidence.

Complaint counsel also calls attention to price cuts initiated by Echlin after Sherman entered the market with kits priced at a discount. There is no evidence that these prices were below Echlin's average variable cost or that they met any of the other criteria for predatory pricing. *See generally International Telephone & Telegraph Corp.*, No. 9000, slip op. at 17–24 (July 25, 1984)[104 F.T.C. 359]. Vigorous price competition is encouraged by the antitrust laws, and an increase in competition can be the expected and desirable result of entry by a new competitor. *See* W. Baumol, J. Panzar & R. Willig, *Contestable Markets and the Theory of Industry Structure* 481 (1982). A price was is evidence of competition, not the absence of competition.

Therefore, we find that there is no barrier to entry into the assembly and sale of carburetor kits. The evidence demonstrates that entry into this market is extraordinarily easy and can be quite rapid. There is thus no possibility that supracompetitive prices for carburetor kits could be maintained and no likelihood that competition will be lessened substantially by the acquisition. [24]

IV. CONCLUSION

Because we conclude that Echlin's acquisition of Borg-Warner's automotive aftermarket division does not violate Section 7 of the Clayton Act or Section 5 of the Federal Trade Commission Act, we affirm the decision of the ALJ dismissing the complaint in all respects.

DISSENTING OPINION OF COMMISSIONER PATRICIA P. BAILEY

This is a merger between competing firms with 36% and 10% of a small and declining market so highly concentrated that six firms account for 95% of sales. The Herfindahl-Hirschman index as a result of this acquisition rises by over 750 points to just under 3000. These figures would suggest that this market is susceptible to collusion. There are few sellers in the market for assembly and sale of carburetor kits, and their market shares have remained stable over the past 15 years. There are large numbers of buyers most of which make relatively small purchases, limiting the ability of buyers to disrupt collusion. Because of the similarity of these buyers' businesses in reselling what are fairly standardized, noncustomized products, there are relatively few issues over which sellers need collude. Substitute products (new and rebuilt carburetors) are considerably more expensive, and demand is alleged to be inelastic, since car repairs create necessity. Industry members use price lists, which facilitates price policing, and discounts off these lists are uncommon. There has been relatively little price competition, according to the ALJ, although he found that non-price competition did exist. There is evidence that the largest respondent exercised price leadership. The question of supracompetitive profits is disputed (the ALJ considered the evidence "fragmentary" and the Commission rejects it without discussion), but industry leaders testified that their operations were profitable. [2]

Under the 1984 Justice Department Merger Guidelines—the most recent government pronouncement on merger analysis—a merger that looks like this one is so likely to be anticompetitive and therefore unlawful that only the "extraordinary" case will avoid legal sanction. The Commission has dismissed this case on the sole ground that it finds no barriers to entry into the market, holding that this conclusion renders the otherwise strong structural case for illegality irrelevant.[1]

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[1] In fact, acknowledgment of complaint counsel's prima facie case is relegated to a footnote in the majority opinion.

I have three primary concerns about the Commission's decision and its implications for future FTC merger policy. First, I believe the Commission has embraced a particularly narrow definition of barriers to entry that may be ill-suited to merger analysis, and which is, moreover, a source of much dispute among industrial economists. Second, I disagree with the conclusion drawn by the Commission, that entry into this market is "extraordinarily easy and can be quite rapid." Finally, as a matter of legal policy, I am concerned over the Commission's single-minded focus on the hotly disputed barriers to entry issue as dispositive of legal liability in a horizontal merger case where the prima facie case for antitrust concern about collusion is as strong as it is here. **[3]**

I.

Barriers to entry are clearly of increasing importance to antitrust analysis. From a conceptional point of view, this is not hard to understand. Former Director of the FTC's Bureau of Economics, F. M. Scherer, has stated that "significant entry barriers are the *sine qua non* of monopoly and oligopoly, for . . . sellers have little or no enduring power over price when entry barriers are nonexistent."[2] The Commission has recognized the role of barriers as a supplement to consideration of quantitative factors such as market shares and concentration. "The issue of entry barriers is perhaps the most important qualitative factor, for if entry barriers are very low it is unlikely that market power, whether individually or collectively exercised, will persist for long."[3] The Department of Justice has gone even further in stating, "If entry into a market is so easy that existing competitors could not succeed in raising price for any significant period of time, the Department is unlikely to challenge mergers in that market."[4] Two recent federal court decisions have hoisted the Justice Department on its own petard **[4]** by denying government merger challenges on the basis of low barriers to entry.[5]

But to say that barriers to entry are important in antitrust thinking does not lead me to the necessary conclusion that barriers analysis has yet reached the point where it should resolve antitrust disputes as easily as it is being used to do in this and in possible future cases.[6] For one, there is such lack of clear consensus about the nature or effect of barriers to entry[7] that some suggest this issue is elusive, and can confound the resolution of complex antitrust questions.[8] One scholar has observed that barriers to entry is "the single most misunderstood topic in the analysis of competition and monopoly," exceeding **[5]** even the issue of market definition in this regard.[9]

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[2] Scherer, *Industrial Market Structure and Economic Performance* 11 (2d ed. 1980).

[3] Statement of Federal Trade Commission Concerning Horizontal Mergers, Section III A(1), p. 5 (1982) (hereafter, "FTC Merger Statement").

[4] U.S. Department of Justice Merger Guidelines, Section 3.3 (1984) (hereafter, "DOJ Merger Guides").

[5] *U.S. v. Waste Management, Inc.*, 743 F. 2d 976 (2d Cir. 1984); *U.S. v. Calmar*, 1985–1 Trade Cas. (CCH) ¶66,588 (D.N.J. 1985).

[6] No matter how appropriate it may be to take entry barriers into account in determining whether or not it is worthwhile to bring divestiture actions against dominant firms in concentrated industries, the case for mode-

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The majority cements its agreement with respondent's definition of entry barriers ("additional long run costs that may be incurred by an entrant relative to the long-run costs faced by incumbent firms"), by a citation to Professor George Stigler, among others. The majority declares this position is "now widely accepted in the legal and economic communities." Stigler's formulation (1968) defines barriers to entry "as a cost of producing (at some or every rate of output) which must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry."[10] This view, as carried forward in the majority's analysis, is that entry barriers block new competition from the market; access to the market is closed to outsiders on account of the barrier. Examples of such barriers given by the majority are governmental entry restrictions and patents. Other examples might be control of scarce resources, such as essential raw materials, or unique management or labor resources. Conversely, under a "Stiglerian" approach, if some factor simply imposes risks and costs on new entrants resulting in possible delay or deferral of entry, that factor is not really a barrier to entry, because access to the market imposes or has already imposed the same costs or risks on all firms, at one time or another. All firms have equal access to the market, even **[6]** given the need to undertake certain prescribed steps to accomplish entry.

Perhaps at the other end of the scale from Stigler's view is the "neo-classical" view of Joe S. Bain (1956), which would measure the prospect of entry by the "extent to which, in the long run, established firms can elevate their selling prices above the minimal average costs of production and distribution (those costs associated with operation at optimal scales) without inducing potential entrants to enter the industry."[11] The condition of entry is thus defined "as the 'disadvantage' of potential entrant firms as compared to established firms or

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rating presumptive merger rules where entry barriers are low is much more tenuous. IV Areeda and Turner, *Antitrust Law* ¶917(b) at 86 (1980).

[7] Demsetz, "Barriers to Entry" 72 Am. Econ. Rev. 47 (1982).

[8] "Determining the existence, 'height,' and effects of entry barriers is beset with some theoretical difficulties and with empirical problems of seemingly formidable proportions." IV Areeda and Turner, supra, ¶917(b) at 87. *See also:* Rowe, "The Decline of Antitrust and the Delusions of Models: The Faustian Pact of Law and Economics," 72 Geo. L. J. 1511 (1984). (Barriers to entry an "elusive" concept.) "Wherever the market, some enterprising rivals, unless kept out by legal fiat, can in time climb in. So, barriers to entry stand only as high as time waxes long and rivals grow tall." *Id.* at 1543.

[9] Fisher, "Diagnosing Monopoly," Q. Rev. Econ. & Bus. 23 (Summer, 1979).

[10] Stigler, *The Organization of Industry* 67 (1968).

[11] Bain, *Industrial Organization* 252 (2d ed. 1968).

conversely, the 'advantage' of established over potential entrant firms."[12] In essence, an entry barrier is whatever allows incumbent firms to charge supra-competitive prices yet not attract new entry. The Bain view, while subject to almost thirty years of criticism by its opponents and revisionism by its friends, remains an alternative approach which provides a different perspective on entry questions.

The Commission distinguishes between "absolute" barriers to entry —which are barriers touched by the Commission's Stiglerian Philosopher's Stone—and mere "impediments" to entry, evidence of which are taken up by the record in this case. (Some of these resemble Bain's barriers to entry sent to the back of the classroom). The Commission finds no absolute [7] barriers to entry in this case at all, but it insists on an extended treatment of the subject, perhaps to accomplish the result of fixing in the caselaw its particular entry barrier definition. As to entry-delaying "impediments," the Commission rules that none of these would permit any exercise of market power by incumbent firms because of the ease with which the impediments could be kicked aside.

The Commission, then, in this opinion embraces the current "Chicago School" economic "State Religion" approach to barriers to entry, a view which simply is *not* generally "accepted [13] in the legal and economic communities." In both communities, though this view has gained some ground recently in a few cases,[14] the battle rages fiercely, and is as empirically unresolved as ever.[15] [8]

II.

But is this point important, or do I belabor an all-too technical issue? It seems to me the point is important if barriers to entry, so particularly defined, become the easy way to resolve complex antitrust cases. Section 7 of the Clayton Act makes illegal mergers that have the probability of substantially lessening competition. The statute does not add the word "forever". A merger can lessen competition and therefore violate the statute, in my view, if market conditions, structural features, or behavioral patterns make entry an unattractive investment risk for a significant period of time. If such a situation exists so as to permit supracompetitive pricing within an industry and yet prevent for a substantial period new entry or the expansion of marginal fringe competitors, then it is possible that a barrier to entry exists. The defect in the Stiglerian alternative is that it does not account for the time, scale and cost necessary for a successful entry that is a meaningful threat to incumbent firms.

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[12] *Id.*

[13] The Commission uses the term "widely accepted." Alas, that may be so, depending however on the circles in which one travels.

[14] Those cases include the Commission's decision in *General Foods Corp.*, 103 F.T.C. 204, 354 n. 54 (1984), where I expressly disassociated myself from the Commission's notational embrace of this Stiglerian view. (103 F.T.C. at 372).

[15] *See* for example, Demsetz, *supra.*; Waterson, "On the Definition and Meaning of Barriers to Entry," 26 *Antitrust Bulletin* 521 (1981), and Wentz, "Mobility Factors in Antitrust Cases: Assessing Market Power in Light of Conditions Affecting Entry and Fringe Expansion," 80 Mich. L. Rev. 1545 (1982).

This situation, as I understand it, is essentially what complaint counsel is arguing. They do not claim that there are any of Stigler's barriers to entry into this market, but rather they assert that entry is unlikely due to the fundamental unattractiveness of the market. New entrants are deterred from making investments in entry because they cannot expect to make acceptable profits. At the very minimum, the argument seems to be, entry would be delayed for a significant period of time **[9]** during which there would be injury to competition, constituting a violation of Section 7.

The majority admits complaint counsel's pragmatic point about conditions that delay or impede entry. The Commission states: "There may be little practical difference between an absolute barrier to entry and conditions of entry that delay the restoration of competitive prices for decades." Delayed entry "for decades" fits an almost-Stiglerian scenario of an industry where potential entrants must await the expiration of patents or overcome similar dramatic entry problems. However, decade-long delays should not be and are not, the only circumstance of concern under the antitrust law.[16] Most temporal measures of new entry speak of difficulty of entry in terms of two to five years.

In the end, the majority concludes that where entry is not blocked (by its analysis), it is easy and can also be rapid—with citation to the entry over the past ten years of about five firms at the fringe of the market. The majority assumes that any of these firms could expand its operations virtually at will. **[10]**

Complaint counsel buttress their statistical case by descriptions of market conditions that permit the exercise of market power without resulting in the expansion of fringe entrants or the entry of new competitors. They view the market as conducive to collusion and highly profitable, but shielded by barriers that deter entry at a significant scale.

The murky issue of profits cannot be finally resolved on this record. While complaint counsel argue that this market enjoys supracompetitive profits and therefore is attractive to entrants, neither the ALJ nor the Commission accepted this analysis.[17] The Commission considers it possible that the [11] industry may be unattractive to entrants because prices are competitive or simply because the market is declining.[18] It is noteworthy that the ALJ, while finding some non-price competition, concluded that "the record as a whole does not reflect vigorous price competition."[19] And, if the declining market simply does not interest outsiders in and of itself, there would seem to be at least modest room for collusion, which this merger might facilitate.

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[16] FTC Merger Statement Section III(A)(1) (1982). ("To be sure, merger analysis properly focuses primarily on long-term competitive implications, but short term effects should not be ignored, particularly if they are substantial.")

[17] The administrative law judge found that the evidence on profitability was fragmentary and hypothetical, since no actual long run profitability data on carburetor kits was available for individual firms. In addition to testimony

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Accepting for the moment that the market is at least somewhat attractive for entry from the initial profitability assessment standpoint, there are alleged to be four factors that complaint counsel say mitigate against entry, but which the Commission rejects even as "impediments."

First, complaint counsel assert there are sunk costs associated with entry that cannot be recovered if a firm decides to exit the market. These sunk costs are not large in terms of dollars, but they are large relative to the expected return in this small ($53 million) and declining market, thereby increasing [12] the risk and decreasing the likelihood of entry given alternative investment opportunities.

Second, complaint counsel contend that entry is deterred by the need to achieve an economy of scale that is quite high. Like the arguments surrounding supracompetitive profits in this record, arguments about economies of scale are a subject of bitter dispute. Complaint counsel's expert witness, using exhibits prepared by respondents, estimated that about 10% of the market represented minimum efficient scale.[20] The ALJ rejected the 10% calculation; he

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by witnesses for four of the leading members of this industry that their companies were profitable, and planning documents of respondent stating its operations are profitable, complaint counsel made use of two *in camera* exhibits prepared by respondents' employees and economic expert. These exhibits are based on data from Echlin's own books and records, originally prepared to establish an economic model of relative costs of production at three different hypothetical levels of output. Complaint counsel, over the vigorous objection of respondents, asserted that this model enabled complaint counsel to establish the profitability of a firm that operated at about 10% of the market, or sales of 1.5 million kits. Comparing these data with 1978-1982 Census Bureau Quarterly Financial Reports (QFR) five-year averages for 1) return on assets for all manufacturing, 2) average return on stockholder's equity, and even 3) return on assets for wholesaling, complaint counsel argues that all of these QFR "benchmarks" are very substantially exceeded by the profit data derived from respondents' economic exhibits. The degree to which these calculated "profits" exceeded the benchmarks (50%) was well above the level agreed by both sides' economic experts to indicate supracompetitive profitability. (Complaint counsel's profit calculations yielded "accounting" rates of return. Such accounting profits are potentially unreliable because they do not take into account certain of a firm's costs; however, complaint counsel explain that in this industry, accounting rates of return closely approximate economic rates of return, considered more reliable evidence of profitability by some economists). In addition, although inferences to be drawn are limited, there is evidence that respondent was able to retaliate against one new market entrant by offering discounts on selected kits ranging from 5-30%. The Commission expressly rules that these sales were not below variable cost. There is the suggestion that respondents' usual prices are normally above a competitive level.

[18] I should note here that the DOJ guides and caselaw do not provide for *per se* legality for mergers in declining industries.

[19] I.D.F. 286, p. 61.

[20] To assess the level of scale economies, complaint counsel again relied on CX 543 and 544, an analysis of the market at three hypothetical levels of output, prepared by respondent's employees from respondents' books and records. These *in camera* exhibits explain certain characteristics of three different sized firms—a firm that produces 1.5 million carburetor kits annually, representing just over 10% of the market, a firm producing 300,000 kits annually or about 2% of the market, and a firm with about 1% of the market, or about 100,000 kits. The data showed, according to complaint counsel, substantially different unit costs associated with each size of output. The

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agreed that there were some scale economies in this industry but considered them insignificant. However, if new entrants were faced with economies of scale of 10%, achievement of this reduction of unit costs would give a decided cost advantage to the larger incumbent firms, and saddle [13] entrants with a major competitive burden to attain these same advantages without prospect of doing so simply from capture of any market growth. Incumbent firms capable of output at these scales could also deliberately flood the market to deter entry with lower prices. Because potential entrants perceive this to be the case, the need to achieve scale economies deters entry.

Third and fourth, complaint counsel also argue that the recent record of new entrants is especially poor in this industry, and that the record shows at least one case of targeted market retaliation by the market leader against a new firm.

Areeda and Turner endorse a shorthand test for barriers to entry by assessing the historical record of entry over the past few years in the market.[21] The 1984 DOJ Guidelines propose a two-year period in which to assess new entry in response to a "small but significant non-transitory increase in price" (about 5% lasting one year).[22] The 1982 FTC statement emphasizes the importance of the historical record on entry.[23] So does the body of traditional caselaw. I believe that judging the historical record on entry has always been, and remains today, the simplest and most practical way to deal with most barrier to entry analysis situations. [14]

While these historical tests emphasize the importance of the traditional study of the simple record of entry, they also emphasize the importance of the size and scope of such entry. The 1984 DOJ Guides would take into account the "magnitude" of entry.[24] The 1982 FTC Statement declares: "Evidence of *substantial* expansion by firms already in an industry, especially non-dominant firms, may persuasively indicate that barriers to larger scale are not high. Conversely, evidence of frequent entry by fringe firms on a small scale *without significant expansion*, may also suggest the existence of barriers to larger scale".[25] (Emphasis added).

The record in this case shows that over more than a decade only

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larger the "firm" the more decided the cost advantage. There is additional evidence that this upper range of output may approximate the optimum in the business expansion plans of another competitor (Holley), allowing it the cost benefits of automated packaging. Respondent is scornful of the economies of scale argument on methodological grounds, on the grounds that the numbers are purely hypothetical, on the fact that only two of the six market incumbents would meet the 10% criteria (although the smaller firms have the existing capability to expand production to 10%, according to complaint counsel's industry expert), and on the fact that the numerous smaller firms appear to be profitable.

[21] IV Areeda and Turner, *supra*, ¶917c, at 66 (1980).

[22] DOJ Merger Guides, Section 3.3 (1984).

[23] FTC Merger Statement Section III A(1) (1982).

[24] DOJ Merger Guides Section 3.3 (1984).

[25] FTC Merger Statement Section III A(1) (1982).

fringe competitors have entered and only to the extent of a total *combined* market share of about 2%. Moreover, expansion or increased profitability has not occurred over a ten year period for some of these firms, and three years or more for others. The majority conclusion that expansion is "easy and rapid," is not supported by the historical record.[26]

There are serious questions in my mind that these struggling fringe competitors represent any disciplining threat on the prices of the market leaders, and unless they do, their entry is not "significant," quite apart from the question of their size. **[15]** The ALJ acknowledged only one firm, Sherman, to be a "significant" competitive entry. The record shows that Sherman's 1981 efforts at assembly and sale of a line of 120 kits at low prices continued for two years with little success. Sherman's survival, with about one-third of one percent of the market may be owed mostly to an agreement to supply kits to another firm for resale, after that firm (Carter) gave up on the assembly and sale of kits on its own (for corporate reasons apparently not related to the kit market). Sherman obtained this account in 1983 by underbidding Borg-Warner's carburetor kits subsidiary. About the time that the Carter/Sherman agreement was implemented, respondent targeted Sherman with special and unusual discounts on 19 lines of fast-moving kits. The Commission's observation about the targeted response to Sherman's entry and Sherman's capture of the lifesaving Carter business after two years of struggle, is that "A price war is evidence of competition, not the absence of competition." That is, Sherman's presence tempered the market leader's prices overall. This is simply not consistent with the selectivity of the response, or the fact that two years passed before it even began. A prospective entrant might take the following view: that a recent entrant, Sherman, was targeted for selective price cuts by a leading firm that almost certainly possessed a cost advantage in calculating the degree of its retaliatory discounting (5–30% off list price, according to the record).[27] How might such a prospect affect the next firm's **[16]** decision to enter the market? To me, this is a relevant question bearing on the likelihood of any further new entry, even at the margin. Of course, it can be said that Borg-Warner's superior efficiency (scale economies) is technically available to all. But, even taking this into account, is the risk worth taking in terms of anticipated post-entry return?

The most obvious pool of potential new entrants are the numerous firms that are private label resellers of kits assembled by the few firms that populate the assembly market. Some of these were formerly assemblers, and all possess some access to distribution systems and the advantage of some name recognition and familiarity with customers. However, the same factors that operate to discourage new entrants, or expansion by fringe entrants, operate to deter resellers, particularly since resellers may be even more knowledgeable and alert than others about the dismal record of entry in this market. Most kit resellers handle small percentages of kit resales, and all but one (Ford) have 3% of such resales or less. Therefore, even firms with established distribution will be forced to capture "changeover" customers if they are to achieve scale economies. But the most significant factor about potential reseller entry is that no reseller has ever successfully entered into kit assembly. The market is clearly unattractive to the new entrants best poised to make the effort, and some factor must account for this fact. [17]

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[26] In contrast, in the recent *Calmer* case, the judge found numerous entrants, some of which had amassed substantial market shares. *U.S. v. Calmar, supra*, at 65, 927–28 (D N.J. 1985).

[27] The fact that the Commission found none of these retaliatory discounts to be predatory suggests that pre-entry price levels were higher than in a competitive environment.

In these circumstances one could predict that further entry is likely to be judged very risky indeed, and given the unlikelihood of any market growth, doomed. With such a poor record on *significant* new entry, the presumption of market power that attends high market shares, high concentration and Herfindahl levels should remain standing, somewhat battered to be sure, but unbowed. If expansion is not occurring, the Commission opines, it simply must be attributable to some factor other than incumbent firms' market power—power normally inferred from the enormous "numbers" in complaint counsel's prima facie case. To suggest that the failure to expand can be based on the invisible evidence of some invisible hand is such a spectral conclusion that it is less credible to me than the anticompetitive inferences to be drawn from the traditional market tests so recently confirmed in the 1982 FTC and 1982 *and* 1984 Justice Department merger frameworks. There are no additional arguments to add to this balance, since there are no credible arguments that this merger enhances efficiency, or that it is likely to promote competition in some other fashion.[28]

In summary, the likelihood of any firm entering this market does not depend simply on the existence or absence of Stigler's [18] entry barriers. The presence of supracompetitive prices may normally be an inducement to entry, but, depending on the record on entry, it may also suggest the historical lesson that entry is risky, and therefore deterred.[29] A firm's decision to take the investment risk depends on its anticipated post-entry rate of return. Initially, a small market that is stable or declining and promises no new growth for an entrant to capture may not be attractive for entry.[30] It might, however, be the sort of market conducive to collusion. Unrecoverable sunk costs are not lightly to be regarded when the ten-year record of entry shows five firms holding two percent, and two of the three largest firms recently merged into a single firm with almost half the market. The few incumbent firms may have the scale economy advantage of lower unit costs, which may permit selective retaliatory pricing that is not, strictly speaking, predatory, but is, generally speaking, entry deterring. And, if there is excess capacity, as there is alleged to be in the two or three incumbent firms that operate at 5–7% of the market, expansion of product "runs" on individual lines of kits could deter entry by easily increasing supply and flooding the market with cheaper **[19]** kits.[31] Finally, assessing once again the historical record of entry, the potential entrant/expander may well be aware that it faces no Stiglerian barriers, and no necessarily enormous capital investment costs in getting a toehold in the market, yet it may anticipate a post entry rate of return that does not justify the effort, given other investment alternatives.[32]

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[28] A claim that social costs of a merger would be small is a much weaker defense than a claim, as in an economies defense, that a merger would yield social gains. The social interest in attempting to isolate and immunize the former is plainly less than the social interest in protecting the latter. It may be sensible to absolve the low-loss cases, but whether it is or not depends heavily on the facility with which they can be identified. IV Areeda and Turner, *supra*, ¶917b at 87.

[29] Stonebreaker, "Corporate Profits and the Risk of Entry," 58 Rev. of Econ. and Stats. 33, 39 (1976). (High profit rates associated with high risks of entry, deter entry, and enable established firms to earn supranormal profits. Record of small firms at the edge of the market an important factor in assessing risk).

III.

Unlike the majority I regard this as a close case, and, on balance, I come out the other way. The major weaknesses arguing against this outcome are the absence of stronger evidence as to supracompetitive profits of incumbent firms, and on economies of scale that may operate to create cost disadvantages. But it is precisely because of the typical—perhaps inherent—**[20]**difficulty and potential ambiguity of such evidence in merger cases that the history of merger law shows a struggle to find simplifying assumptions that can proxy for economic proof positive. Examples of these assumptions to which I am willing to give credence, based on my reading of the law, the 1982 and 1984 DOJ Guides, and the 1982 FTC Statement on Horizontal Mergers, are that high market shares and Herfindahls indicate the prospect for collusion and that a long record of failed or marginal entry raises and inference of high entry barriers.

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[30] DOJ Merger Guides, Section 3.3 n. 21 (1984); Webbink, Entry, Price-Cost Margins and Barriers to Entry in 280 4-Digit Industries, 1967–1972, Federal Trade Commission Bureau of Economics Working Paper No. 19, 5, 14 (1979).

[31] Spence, "Entry, Capacity, Investment and Oligopolistic Pricing," 8 Bell J. Econ. 534 (1978); Dixit, "A Model of Duopoly Suggesting a Theory of Entry Barriers," 10 Bell J. Econ. 20, 21 (1979) ("The threat of a large enough post-entry output will make entry seem unprofitable, and then it need never be implemented"); Wenders, "Excess Capacity as a Barrier to Entry," 20 J. of Ind. Econ. 14 (1971).

[32] The entrant should ignore preentry price and profit levels, but attempt to infer the postentry equilibrium price and profit levels. If the entrant's expected profits are negative, he is deterred; the no-entry profits accrue to the already established firm rather than the equally efficient entrant. Even a more efficient entrant may be deterred by an established firm who has sunk sufficient costs to make his own exit uneconomical, and hence, entry mutually destructive. Salop, "Strategic Entry Deterrence," 69 Am. Econ. Rev. 335 (1979).

The sun has probably set on the rule of presumptive illegality in horizontal merger cases, such as outlined in *U.S. v. Philadelphia National Bank*, 374 U.S. 321, 364–66 (1963).[33] Yet have we not gone all the way in the other direction if we say that the *only* relevant question is whether particularly defined barriers to entry are high or low, irrespective of the traditional indicia of antitrust concerns about enhanced potential for collusion? I seriously question, based on the facts of this case, whether any true advance in our knowledge of how this market really works is promoted by a rigid economic theory of "absolute" barriers to entry, or a notion of "delayed" entry in terms of decades. Certainly such an economic theory is outcome determinative, just as was the old rule of presumptive **[21]** illegality. The analysis contained in this opinion of the Commission denies us the latitude to consider whether market structure, performance or conduct in a given case leads rational potential entrants to walk away, on the basis of their assessment of risks they face and the sorry record of the firms the Commission here would call "new entrants." One wonders why the FTC and the Department of Justice have spilled so much ink over how to analyze mergers, if it is all as easy as this. The clear implication of the writing and then rewriting of the DOJ Guides was that merger analysis was complicated stuff, and that fair enforcers should take into account relatively sophisticated analysis of all aspects of the market. I suggest that the majority has turned the old Section 7 "numbers" game on its head in favor of a "quick look" approach for Stigler's barriers to entry, the new *primus inter pares* of merger law. One result of such an approach would be to sanction any and all mergers in this market, right up to the point where a pure monopoly results. If there are no barriers to entry, after all, what would be wrong with that?[34] The entry barriers "quick look" test leads to a rule of *per se* legality for many mergers.

It is, of course, always possible that the distinguished and expert majority is dead right with their election of the economic theory to drive the result in this case. But my own brief **[22]** assessment of the literature on this issue shows it long on words and short on empirical findings. There is no surfeit of discussions of the issues, but no agreement on them, either.

What is emerging in Commission merger decisions is by and large the rule that, according to the "new" economic learning, a merger is almost always legal. The Commission has charted a new course away from the great body of the traditional caselaw, and indeed abandoned the assumptions that have attended merger enforcement policy of both old and recent vintage, substituting a well-nigh theological—and surely theoretical—economic *deus ex machina.*

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[33] However, Judge Winter in *Waste Management* observed that the Supreme Court has never expressly stated that ease of entry is one of the circumstances that fits the Court's approving assessment of market conditions to supplement the statistical market share and concentration data of the prima facie case, such as occurred in *U.S. v. General Dynamics Corp.*, 415 U.S. 486 (1974). 743 F. 2d at 982 (1984).

[34] Or, as the Commission opinion puts it, "In the absence of barriers to entry, incumbent firms cannot exercise market power, regardless of the concentration in the nominal 'market,' and even if that 'market' has been 'monopolized' by a single firm."

FINAL ORDER

This matter has been heard by the Commission upon the appeals of complaint counsel and respondent The Echlin Manufacturing Company from the initial decision and upon briefs and oral argument in support of and in opposition to the appeals. For the reasons stated in the accompanying Opinion, the Commission has determined to affirm the initial decision. Accordingly,

It is ordered, That the complaint is dismissed.

Commissioner Bailey dissented.

Proposed development of a relative value guide for physician services to be distributed to member internists would be likely to have anticompetitive effects that probably would not be outweighed by any countervailing efficiency justifications. [*American Society of Internal Medicine, P84 3532*]

April 19, 1985

Dear Mr. Kopit:

This letter responds to your request for an advisory opinion concerning the legality of the American Society of Internal Medicine's ("ASIM") proposal to develop and disseminate relative value guides ("RVGs"). The Commission has determined, on the basis of the information provided by ASIM and additional information gathered by Commission staff, that there is substantial danger the proposed conduct would lead to a combination or conspiracy that unreasonably restrains competition among physicians in violation of Section 5 of the Federal Trade Commission Act. The Commission, therefore, cannot give advance approval to ASIM's RVG proposal.

This advisory opinion begins with a brief summary of ASIM's proposal. It then discusses two central questions—first, whether there is substantial danger of an agreement in restraint of trade resulting from the proposed conduct, and second, whether, were such an agreement to result, it would restrain trade unreasonably. The letter then indicates alternative actions, unlikely to raise antitrust problems, that ASIM can pursue to redress the alleged reimbursement disparities about which it is concerned.

ASIM's Proposal

ASIM, a national professional society consisting of approximately 19,000 doctors of internal medicine, proposes to develop an RVG and distribute it to its member physicians and to private and governmental third-party payors on an advisory basis. ASIM plans to request that these parties consider using the RVG as a guide in developing reimbursement programs consistent with the approach contained in the RVG. The RVG would cover services that are provided by physicians who specialize in internal medicine ("internists"). ASIM proposes in the future to work with other physician organizations, including surgical societies, to develop RVGs for other medical and surgical services.

The proposed RVG would list medical services by descriptive codes. ASIM intends to assign numeric values to each coded service, relative to one another, determined on the basis of costs, time, complexity, and the level of training required to perform each service. The RVG would not in itself be a fee schedule, but could be converted to a fee schedule by physicians or third-party payors simply by multiplying the relative values by a dollar conversion factor. ASIM has indicated that it would not provide conversion factors with its RVG; that the RVG and the other proposed aspects of ASIM's conduct would be voluntary and "advisory" in nature; and that there would be no explicit or implicit threats or coercion against physicians or third-party payors to induce them to use the RVG.

ASIM has stated that it wants to develop the RVG to redress an alleged disparity in reimbursement for "cognitive" and "procedural" services provided by physicians. According to ASIM, a high level of insurance reimbursement now encourages physicians to use and sometimes overuse costly "procedural" services such as surgery, electrocardiograms, x-rays, and other technology-intensive services. At the same time, ASIM submits, relatively low levels of reimbursement discourage physicians from using more time-consuming "cognitive" services such as the diagnosis of patient health care problems, preventative education, and life style evaluation. ASIM's members are internists, most of whom are chiefly engaged in primary care and the delivery of cognitive services. ASIM proposes to increase the relative value of cognitive services and decrease the relative value of procedural services to encourage use of more cognitive services and discourage overuse of procedural services. ASIM states that its RVG, if widely adopted, would reduce health care costs by creating incentives to substitute low-cost care for high-cost care. It further states that an increase in the relative amount at which cognitive services are reimbursed, as compared to procedural services, would encourage physicians to spend more time in personalized aspects of care and would provide new incentives for physicians to choose primary care specialties utilizing relatively large amounts of cognitive services.

ASIM plans to use the "Delphi technique" to reach consensus on the relative values to be assigned to each of the services commonly provided by internists. In separate mail surveys, representatives of internal medicine subspecialty[1] organizations and two ASIM state affiliates would be asked anonymously to assign relative values to medical services on the basis of time, complexity, costs, and training. Median and average figures computed by ASIM based on the first round of responses would then be submitted to the same physicians to use in making a second round of responses. The process would continue until a consensus or as much uniformity as possible was reached. ASIM's Resource Cost Committee would then review the product of each of these survey determinations and determine relative values using the Delphi consensus-building technique. The resulting RVG would then be submitted to ASIM's Board of Trustees for approval or disapproval without modification.

ASIM also plans to send a "white paper" to physicians and third-party payors that would explain the cognitive/procedural reimbursement disparity and use of its RVG to reduce the disparity. It would also illustrate how to use the RVG to "change the reimbursement structure from the current procedural service basis to a cost of resources basis." The stated purpose of the "white paper" would be to persuade and not to coerce.

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[1] Internal medicine subspecialties include cardiology, gastroenterology, allergy, endocrinology, hematology, oncology, nephrology, rheumatology, infectious disease, and chest disease.

Legal Analysis

The antitrust issue raised by ASIM's proposal is whether it presents a substantial danger of an agreement that unreasonably restrains trade.[2] The threshold question in resolving this issue is whether there is danger of an agreement in restraint of trade. If there is a substantial danger of such an agreement occurring, the second question is whether there is a substantial danger that it would unreasonably restrain trade. The antitrust laws prohibit, of course, only those agreements that restrain trade unreasonably.[3]

Danger of Agreement in Restraint of Trade

ASIM's adoption and dissemination of an RVG, as it proposes, could involve or facilitate two types of agreements in restraint of trade: (1) an agreement among ASIM, its members, and possibly other physicians to adhere to the RVG in determining charges for their services; and (2) an agreement between ASIM, acting on behalf of its members, and one or more third-party payors, possibly resulting from coercion, that the third-party payor(s) will adhere to the RVG in reimbursing physicians for covered services. The Commission concludes there is a substantial danger that the first type of agreement may occur; there does not appear to be a substantial danger of the second type of agreement.

With respect to the first type of agreement, if a professional association expressly or implicitly suggests or advises marketplace conduct on the part of its members or other competitors and the intent or likely consequence of the communication is that association members or others will concertedly or interdependently modify their behavior in the marketplace to restrain trade, both the professional association and the individuals so acting could properly be found to be parties to an agreement in restraint of trade.[4] In contrast, when an association provides information or advice to its members or others that could be used by its recipients unilaterally in the marketplace and it is neither intended nor likely that the communication will result in concerted, interdependent action to restrain trade, the association would probably not be found party to an agreement in restraint of trade.[5] In this matter, the substance and market context of ASIM's communications and physician actions in response to them would be critical in determining the existence of an agreement in restraint of trade.

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[2] The Commission discusses the antitrust risks of ASIM's proposal in terms of "substantial danger" because this advisory opinion seeks approval for proposed future conduct, the precise nature and specific effects of which cannot now be determined.

[3] *United States v. Standard Oil Co.*, 221 U.S. 1, 59–60 (1911).

[4] *See generally Interstate Circuit, Inc. v. United States*, 306 U.S. 208, 226–27 (1939) ("It was enough [for an unlawful conspiracy] that, knowing that concerted action was contemplated and invited, the[y] gave their adherence to the scheme and participated in it. Each . . . was advised that the others were asked to participate; each knew that cooperation was essential to successful operation of the plan. They knew that the plan, if carried out, would result in a restraint of commerce, which . . . was unreasonable . . ., and knowing it, all participated in the plan.").

Although any action by ASIM, an association of individual practitioners many of whom compete with one another, to develop an RVG would reflect an agreement to take that action, ASIM's development of an RVG, standing alone, would not constitute an agreement *in restraint of trade.* No one would be party to an understanding by which he or she is committed to any particular course of conduct in the marketplace. However, antitrust analysis of ASIM's proposal must be focused on the entire course of conduct planned by ASIM to determine whether the proposal is intended to or could be expected to involve or facilitate an agreement in restraint of trade.

Several factors indicate there is substantial danger that ASIM's proposed conduct would be intended to or would result in concerted, interdependent action by physicians *to adhere to the RVG* in pricing their services. Despite the disclaimers it would make in its distribution of the RVG, ASIM appears to be proposing implicitly to invite physicians to adhere to the RVG in determining their charges. ASIM plans to send members the RVG on a "purely advisory" basis, leaving individual members "free to make independent fee decisions", with a "white paper" that would "illustrate 'how to' use the [RVG] to change the current reimbursement structure." The RVG would be prescriptive in nature, describing a set of pricing relationships that ASIM would be supporting as what *should* be. The RVG would be designed to *change* future market transactions with respect to physician charges and output. Such pricing information programs are more likely to result in agreements in restraint of trade than are exchanges of descriptive data, which merely describe or reflect historical or current market transactions.[6] Indeed, there is a danger that use of the RVG could lead to an agreement among physicians on a single conversion factor to apply to each service on the RVG. Thus, the RVG could easily become the means for physicians in at least some communities to coordinate a collusive pricing scheme.

Further, for a number of reasons there appears to be a substantial danger that concerted adherence to the RVG by physicians in response to ASIM's invitation would be widespread. The invitation to use the RVG would emanate from a leading national medical specialty association and would presumably have the support of the other medical organizations that would have helped to build the "consensus" the RVG reflects. Concerted adherence to an ASIM RVG would appear more likely than if an independent outside organization were to formulate an RVG. Moreover, ASIM's invitation to adhere to the RVG would be attractive to the many primary care physicians who would benefit financially from increased reimbursement for cognitive services. Also, the RVG would be circulated in a form easily used by individual physicians in setting their prices. It would require only that the physician identify the appropriate code for each medical service rendered and apply a conversion factor he or she selects to each listed relative value to determine his or her charge for every service.

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[5] *See generally Monsanto v. Spray-Rite Service Corp.*, 104 S.Ct. 1464, 1471 (1984) (To find an agreement, "[t]here must be evidence that tends to exclude the possibility that the manufacturer and the nonterminated distributors were acting independently. . . . [T]he antitrust plaintiff should present direct or circumstantial evidence that reasonably tends to prove that the manufacturer and others 'had a conscious commitment to a common scheme designed to achieve an unlawful objective.' " (citation omitted)); *First Nat'l Bank v. Cities Service Co.*, 391 U.S. 253, 274–88 (1962) (the inference of a conspiracy does not logically follow in the absence of either direct conspiratorial evidence or motive to enter a tacit agreement).

[6] *See Goldfarb v. Virginia State Bar*, 421 U.S. 773, 781 (1975); *Maple Flooring Mfrs' Ass'n v. United States*, 268 U.S. 563, 585–86 (1925).

Widespread adherence to the RVG by physicians in local communities would likely be interdependent because it would probably not be in the economic self-interest of individual physicians to charge on the basis of the RVG unless they believe most competing physicians would be doing likewise. Physicians choosing to price in conformance with the RVG would likely do so to effect increases in the absolute level of their charges for cognitive services.[7] If only a few physicians were to increase their charges for cognitive services, insurers might refuse to pay the increased amounts on the ground that for each such physician, it reflected a fee exceeding the "usual and customary" charge of internists. In light of increasing competition at the primary care level, individual physicians considering adherence to the RVG would know that patients who were not fully reimbursed by insurance and who incurred higher out-of-pocket costs for cognitive services could over time go elsewhere for their medical care (*e.g.*, to other private practice physicians or to health maintenance organizations). If most primary care physicians in an area adhered to the RVG, in contrast, insurers' "customary" screen levels would over time increase, likely resulting in higher reimbursement allowances. Patients would then have less incentive to seek, and could less easily find, a lower-cost provider. Thus, concerted or interdependent conduct by a very substantial number of physicians could succeed, and would probably be necessary to succeed, in raising the relative price level of cognitive services. If concerted conduct were not necessary, physicians concerned about the disparity identified by ASIM could address it unilaterally, and presumably already would have in their own practices, by increasing charges for cognitive services. ASIM's likely knowledge that individual physicians probably could only effectively use the RVG interdependently, or concertedly, would help support a finding that ASIM contemplated a concerted response by physicians to its promulgation of the RVG.

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[7] Adherence to the RVG would likely require physicians to depart from their current fee schedules. It would be unlikely that physicians would voluntarily elect to conform to the RVG and choose conversion factors that would keep their prices for cognitive services at roughly their current levels and would result in reduction of their charges for procedural services.

Finally, to the extent third-party payor coverage "desensitizes" insured patients to price increases, concerted conformance to the RVG in an effort to raise charges for cognitive services would be more likely contemplated, attempted, and successful in the medical marketplace than restraints of trade in other market contexts in which consumers are more "price sensitive." If the RVG were adhered to by a substantial number of physicians, then "discounting" might not be as advantageous for physician competitors as it typically is for other competitors seeking to undercut higher charges resulting from collusion. As noted above, general adherence to the RVG would likely create a new range of "customary" charges, so that third-party payors would, as time passes, likely recognize and pay higher charges for cognitive services. In this event, even if some physicians did not adopt the RVG and charged lower prices for cognitive services, they might not be able to undercut effectively those adhering to the RVG because fees below those recognized as customary by insurers might not attract many insured patients away from other physicians. Patients with paid-in-full insurance coverage or only small co-payment obligations, who are treated by physicians whose fees are within the "customary" range, could have little, if any, monetary incentive to switch physicians.

The Commission recognizes, notwithstanding the foregoing discussion, that substantial arguments can be made against the likelihood that concerted adherence to the RVG would result from ASIM's proposed conduct. For example, physicians' different cost structures and diversity across the country in practice patterns and pricing relationships among various medical subspecialties may make it unlikely that physicians would reach a common understanding to utilize any single RVG. Also, the cost-containment practices of third-party payors would pose a major obstacle. Nonetheless, although the Commission cannot, in this advisory opinion context, predict that widespread concerted conformance to the RVG would necessarily result from its dissemination by ASIM, the available information on this specific RVG proposal indicates that this type of agreement in restraint of trade is a substantial danger.

ASIM also proposes to disseminate its RVG to insurers and other third-party payors and encourage them to adopt the RVG as a basis for their reimbursement structures. This conduct raises the question of whether ASIM's proposal may lead to the second type of possible agreement in restraint of trade discussed above—an agreement between ASIM, on behalf of its members, and third-party payors that such third-party payors will adhere to the RVG in their reimbursement systems. Such an agreement between ASIM and a third-party payor could lessen competition among ASIM's members over the terms of their dealings with the third-party payor. The Commission does not find a substantial danger that this type of an agreement would result from the proposed conduct.[8]

No agreement in restraint of trade involving ASIM occurs if a third-party payor decides to adopt an RVG as the basis for its reimbursement system, even if its decision results from discussions with ASIM, so long as the third-party payor's decision is a unilateral one, *i.e.*, is not the result of coercion by ASIM or of an *agreement*, coerced or voluntary, between ASIM and the third-party payor.[9]

In this regard, ASIM's request letter states that its discussions with third-party payors would be advisory and not coercive in nature. ASIM also states that it would not be acting as a common agent or in a representative capacity for its members in its dealing with third-party payors; rather it would simply seek to persuade third-party payors of the efficacy of reimbursement systems based on the RVG. Based on these representations and the absence of factors indicating serious risk in this regard, the Commission does not believe there is a substantial danger that ASIM will negotiate an agreement with, or coerce, third-party payors to use the RVG, so as to constitute an agreement in restraint of trade.[10]

Reasonableness of Potential Agreement in Restraint of Trade

Because the Commission has concluded there is a substantial danger that ASIM's proposed conduct would involve an agreement in restraint of trade among ASIM and physicians to concertedly adhere to the RVG, the remaining issue is whether such an agreement would *unreasonably* restrain trade and therefore be illegal. The Commission concludes that such an agreement would be inherently suspect, in light of its purposes and likely anticompetitive effects. The Commission further concludes that the likely anticompetitive effects of such an agreement probably would not be outweighed by any countervailing efficiency justifications that may flow from ASIM's proposed conduct. As a result, as is discussed below, an agreement among physicians to adhere to the ASIM RVG would be likely to restrain trade unreasonably. The Commission, therefore, cannot approve ASIM's proposed actions.

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[8] Because of the conclusion reached in this advisory opinion, it is not necessary to reach the question of whether an agreement to adopt and promulgate an RVG by a medical society could result in an unreasonable restraint of trade, even absent a finding of concerted adherence to it by physicians or an agreement between the medical society and any third-party payors.

[9] *See Virginia Academy of Clinical Psychologists v. Blue Shield of Va.*, 624 F.2d 476, 483 (4th Cir. 1980), *cert. denied*, 450 U.S. 916 (1981); *Michigan State Medical Soc'y*, 101 F.T.C. 191, 286 (1983) (*"MSMS"*); *Monsanto*, 104 S.Ct. at 1471.

[10] ASIM's development of an RVG for dissemination to third-party payors, although not raising an apparent substantial danger of agreement in restraint of trade between ASIM and third-party payors, could nonetheless result in an agreement between ASIM and its members to adhere to the RVG. If ASIM were to develop an RVG and support it in discussions with third-party payors, its members' knowledge of this action and the specifics of the RVG could result in concerted adherence to it for many of the same reasons stated above. Although the evidentiary situation would be different, this conduct could raise antitrust risks like those resulting from direct dissemination of the RVG to ASIM's members with encouragement to use it.

Naked horizontal agreements to restrict output or tamper with price are *per se* illegal. No elaborate inquiry into market power or actual effects is required for condemnation of such agreements under the antitrust laws, and insistence on the "need" in the marketplace for such arrangements cannot provide a defense.[11] An agreement on precise fees is not required for a finding of illegality.[12] "Any combination which tampers with price structures is engaged in unlawful activity . . . . [T]o the extent that they raised, lowered, or stabilized prices they would be directly interfering with the free play of market forces."[13] As the Supreme Court has recognized, "An agreement to pay or charge rigid, uniform prices would be an illegal agreement under the Sherman Act. But so would agreements *to raise or lower* prices whatever machinery for price-fixing was used."[14] Thus, an agreement to use a particular formula, like an RVG, could support a finding of illegal price-fixing,[15] because "tampering with the means of setting prices is tantamount to tampering with reimbursement levels."[16] Similarly, the Supreme Court has condemned as *per se* unlawful a horizontal agreement to fix only one element of price, such as credit terms.[17]

If an agreement encompassing promulgation and adherence to the ASIM RVG is found, the agreement would have purposes and likely effects that under the foregoing precedent would condemn the agreement as *per se* unlawful absent plausible efficiency justifications. The agreement would tamper with market pricing structures, and pose a serious danger of higher prices, at least with respect to some medical services, and other anticompetitive effects.

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[11] *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 218 (1940); *NCAA v. Board of Regents of University of Oklahoma*, 104 S.Ct. 2948, 2960, 2965 (1984).

[12] *Per se* condemnation has been deemed appropriate even when 1) suggested prices were used by a trade association's members only as a "starting point" for individual negotiations and price competition continued, *Plymouth Dealers Ass'n of N. Cal. v. United States*, 279 F.2d 128, 132 (9th Cir. 1960), and 2) there were no sanctions against members not adhering to the suggested prices and suggested prices in fact were not strictly adhered to by members, *United States v. Nationwide Trailer Rental Sys., Inc.*, 156 F.Supp. 800, (D. Kan.), *aff'd per curiam*, 355 U.S. 10 (1957). In regard to "advisory" price schedules possibly supporting a finding of agreement in restraint of trade *compare* dictum in *Goldfarb*, 421 U.S. at 781 (1975) ("[a] purely advisory fee schedule issued to provide guidelines . . . without a showing of an actual restraint on trade, would present us with a different question") *with United States v. National Ass'n of Real Estate Bds.*, 339 U.S. 485, 488–89 (1950) (in regard to a "non-mandatory" rate schedule, "[s]ubtle influences may be just as effective as the threat or use of formal sanctions to hold people in line").

[13] *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 346 (1982) (quoting *Socony-Vacuum*). *See also MSMS*, 101 F.T.C. at 291.

[14] *Socony-Vacuum*, 310 U.S. at 222 (emphasis added).

[15] *Cf. Morrison v. Nissan Motor Co.*, 601 F.2d 139 (4th Cir. 1979) (regarding an automobile repair flat rate manual).

[16] *MSMS*, 101 F.T.C. at 291.

[17] *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643 (1980).

First, the agreement would tamper with the market's pricing structures by locking competing physicians into use of a particular pricing formula, if not uniform prices. It would fix the relationships among each physician's prices for different services, so that ratio would not depend upon the production costs or quality of each physician's service, nor on the degree of demand he or she faces for various services.

Second, use by physicians of the proposed RVG would apparently be designed to achieve, and would likely result in, payment and reimbursement for cognitive services at higher absolute levels than prevail currently. It can be inferred from ASIM's own statements that ASIM's purpose in developing the RVG includes raising prices for cognitive services *on an absolute basis* as well as on a relative basis. Examples include an ASIM resolution in 1983 stating: "Resolved, that in ASIM's campaign to reduce the discrepancy in reimbursement between cognitive and procedural services, the Board of Trustees continues to actively promote *enhanced reimbursement* for cognitive services . . . ."[18] In proposing in 1982 that the Department of Health and Human Services adopt an RVG demonstration project, ASIM stated, "A new schedule of allowance providing for *increased reimbursement* for internist's cognitive services would be created."[19] Moreover, ASIM very likely knows that its members would have every incentive to use the RVG to increase the absolute level of their prices for cognitive services. As noted above, physicians who voluntarily convert their current fee schedules to the new ASIM RVG would be unlikely to adopt a conversion factor that would result in lower prices for procedural services and no increase in their cognitive services charges. The effect of widespread use of the ASIM RVG by physicians to bill higher fees for cognitive services, even without the RVG's explicit adoption by third-party payors, would likely be incorporated into third-party payors' physician fee profile data for computing usual, customary, and reasonable charges and raise third-party payors' reimbursement levels for cognitive services.

Third, a "fragmentation" phenomenon of new billing categories being created has apparently arisen with use of some other RVGs and could in the instant case result in increases in overall billing charges. For example, a study of the California Medical Association RVG concluded that more detailed and fractionalized RVG descriptive codes resulted in overall increases in payments to physicians.[20] Here, there is some danger, for example, of ASIM's RVG providing for new charges by procedure-oriented physicians for cognitive aspects of services, when patients were previously charged only for a procedure.

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[18] ASIM, *Reference Committee B Report, 1983 House of Delegates* 4 (emphasis added).

[19] ASIM, *Proposal for a Demonstration Project* 3 (Oct. 1982) (emphasis added).

[20] Sobaski, *Health Ins. Statistics*, USDHEW, *Effects of the 1969 California Relative Value Studies on Costs of Physician Services Under SMI*, Pub. No. (SSA) 75-11702 (June 20, 1975), at 5; *see also* Urban Institute, *Alternative Methods of Developing a Relative Value Scale of Physicians' Services: Year End Report* 7-8 (1983) (*"Urban Institute Study"*).

Such a tendency in the ASIM RVG could arise in the evolution of the "consensus" needed among both cognitive and procedure-oriented physicians for the RVG's contents.[21]

Fourth, widespread adherence to the RVG could also tend to stabilize prices artificially. Such a phenonemon could be in contrast to the stability of price one might expect in a competitive market in which homogeneous, fungible goods are sold. The price relationships of different services, and possibly absolute prices as well,[22] would be stabilized to a degree not already effected by third-party payment and without regard to differences in the quality of each physician's services or his or her efficiency.

Fifth, the RVG may also facilitate direct price fixing. In the absence of an RVG the difficulties in forming a consensus among physicians on a fee schedule would involve deciding which services to include in a price-fixing agreement and agreeing on what value each service should have in relation to another. Agreement on a full-blown fee schedule would be facilitated by adherence to the RVG and would involve additional agreement only on a conversion factor. Although ASIM has disclaimed any intent to encourage such conduct, agreements among physicians to use a particular conversion factor with an RVG can arise. Agreement on conversion factors does not appear to be a part of ASIM's plan nor an inevitable result of it, but it is a possible result of ASIM's conduct, particularly in subspecialties at local levels.

Finally, in addition to affecting price, concerted adherence to ASIM's RVG would also appear to fix or restrict output of certain services, also a type of agreement that can be *per se* illegal.[23] ASIM's stated intent is to change the mix of cognitive and procedural services delivered by internists, if not all physicians, through change in reimbursement levels. ASIM's proposal apparently contemplates a reduction in the output of procedural services, and could, depending on the impact on demand of any significant price increases for cognitive services, reduce output of cognitive services.

Because of its apparent purpose to raise price levels for some services and the substantial danger of anticompetitive effects on price and output, the agreement to adhere to the RVG that could result from ASIM's proposal would be inherently suspect or *prima facie* anticompetitive. Such an agreement would not be condemned outright under the *per se* rule as a naked restraint of trade if a plausible procompetitive efficiency rationale existed for it, but the burden would be on ASIM to establish justifications legitimizing the agreement.[24] If ASIM established procompetitive efficiency justifications, they would then be weighed against the anticompetitive effects of the conduct to determine net competitive effects. If such justifications were not shown to be valid, the *prima facie* anticompetitive or inherently suspect conduct in question would be condemned without further proof of anticompetitive effects.[25] This method of analysis can be deemed a truncated, quick-look, or limited rule of reason analysis.[26]

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[21] *See Am. Med. News*, Nov. 23/30, 1984, at 30, col. 3 (surgical society official quoted as stating there is "cognition in the OR [operating room] too"); *see also Am. Med. News*, Oct. 14, 1983, at 14, col. 1 (surgical society official quoted as stating "surgeons use cognition before, during and after surgery"; physician quoted as stating that "resistance" of surgeons to concept of reducing cognitive and procedural services disparity began to "disappear" in state medical society when internists explained to surgeons that, "because of the reimbursement bias," "surgeons do a lot of cognitive consultations that they have to consider throwaways" or "time lost").

[22] An empirical study suggests that RVG use is associated with less fee dispersion, although not necessarily higher fees. B. Eisenberg, *Information Exchange Among Competitors: The Issue of Relative Value Scales for Physicians' Services*, 23 J.L. & Econ. 441, 457–58 (1980). The study's data were not sufficient to indicate whether the reduction in dispersion reflected more efficient market performance, or a possibly unwarranted trend toward standardized prices by physicians offering differing quality service. The study did find a positive association between RVG use and higher prices, but the association was not statistically significant.

[23] *NCAA*, 104 S.Ct. at 2948; *National Macaroni Mfrs. v. FTC*, 65 F.T.C. 583 (1964), *aff'd*, 345 F.2d 421 (7th Cir. 1965).

Showing adequate justification for concerted promulgation and adherence to ASIM's RVG would be particularly critical given the power of ASIM and those physicians, both ASIM members and others, who might concertedly use the RVG to effect significant changes in the marketplace. ASIM membership includes 19,000 physicians, a significant portion of the nation's 63,000 internists. The Commission understands that ASIM also has the support of at least 12 other physician organizations in its effort to make cognitive services reimbursement more "equitable." Concerted action by physicians who are members of these organizations to adhere to the RVG would likely have a substantial effect on the marketplace. In addition, primary care physicians who are not members of these organizations might also be attracted to the ASIM RVG because use of it would be in their financial interest. Finally, future proposed ASIM RVG activity encompassing all physician services could command widespread, across-the-board adherence by physicians in all specialties.

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[24] *NCAA*, 104 S.Ct. at 2967; *cf. MSMS*, 101 F.T.C. at 291; *see generally* Brunet, *Streamlining Antitrust Litigation By "Facial Examination" Of Restraints: The Burger Court And The Per Se - Rule Of Reason Distinction*, 60 Wash. L. Rev. 1 (1984).

[25] *United States v. American Soc'y of Anesthesiologists, Inc.*, 473 F.Supp. 147 (S.D.N.Y. 1979) ("*ASA*"), cited by ASIM, warrants discussion. In that case, the court rejected the Department of Justice's contention that ASA committed a *per se* violation of the Sherman Act through its dissemination of an RVG for anesthesia services and found no violation under the rule of reason. The *ASA* case was tried solely on a *per se* theory so there was no full exposition of possible anticompetitive effects. The court, in fact, found no agreement to adhere to the RVG with the purpose or effect of raising or stabilizing price, *ASA* at 159, and instead found that ASA had not "encouraged" anyone to use its RVG. No evidence was cited showing any intent on the part of ASA to achieve an increase in fee levels. *ASA* at 159–60. The court also emphasized that delivery of anesthesia services is somewhat unique in medical practice—little or no contact with patients prior to surgery and virtually 100 percent insurance coverage of fees. *Id.* The present matter differs significantly in these respects.

[26] *See, e.g., General Leaseways v. National Truck Leasing Ass'n*, 744 F.2d 588, 595–96 (7th Cir. 1984) (preliminary injunction); Brief for the United States as *Amicus Curiae* in Support of Affirmance, *NCAA* at 9–12. In reference to the quick-look rule of reason, "[s]easoned antitrust lawyers recognize that the threshold facial examination is not that novel and is entirely consistent with older landmark cases. *United States v. Addyston Pipe and Steel Co.* evidences the historical foundation underlying the quick look method." Brunet, *supra* note 24, at 22. Even if a full-blown rule of reason analysis were the appropriate mode of analysis for an agreement encompassing concerted adherence to ASIM's RVG, the apparently anticompetitive purposes and potential effects discussed above, and the likelihood that ASIM members and other physicians collectively using the RVG could exercise market power as discussed below, would very likely make out a *prima facie* case, once established in an evidentiary record. ASIM would then, as in a truncated rule of reason analysis, have to proffer evidence showing procompetitive effects of greater or at least equivalent weight.

ASIM's stated justification is essentially that imperfections in the insurance payment system for reimbursing physicians have created "wrong incentives," *i.e.*, a high level of reimbursement for costly technological and procedural services, which encourages overuse and more expensive medical care, and a low level of reimbursement for cognitive services, which discourages their use. ASIM further claims that redressing the reimbursement disparity between procedural and cognitive services through its proposed RVG would encourage greater use of more personalized cognitive services and provide new incentives for more physicians to choose primary care specialties. ASIM claims that its proposed RVG, besides influencing physicians to better meet the public's overall health needs, would be designed to reduce health care costs.

ASIM's purported objective—a lower-cost medical services marketplace, with concomitant health benefits to patients—is laudable. However, that objective would not provide a cognizable justification or defense under the antitrust laws for an agreement to supplant determination of prices by market forces on the ground that prevailing prices were not at a level the parties to the agreement believed was optimal for them or society.[27] In *Professional Eng'rs,* the Supreme Court confirmed that activities of professional societies are subject to the traditional antitrust test of reasonableness—"whether the challenged agreement is one that promotes competition or one that suppresses competition"—and may not be defended on the ground that the special characteristics of professional services markets make competitively determined prices undesirable.

The difficulties in recognizing the availability of such a defense for an agreement to adhere to the ASIM RVG are illustrated by the issues that would have to be resolved to determine its validity. A principal factual issue would be determining the accuracy of ASIM's claim that pricing levels and output in the medical services marketplace are not at appropriate levels. If such nonoptimal performance is proven, one would then have to determine whether the results of the conduct in question would be improvement or worsening of the market. A court might well have to assess the likely result of physicians forming and acting upon a subjective consensus judgment, based on cost and other factors, of what pricing relationships would prevail in the market were the market working properly. This inquiry would be akin to the regulatory determination of a public utility commission and would go beyond any inquiry undertaken in prior antitrust cases. Indeed, to attempt to resolve empirically whether competition and consumers would ultimately be served or harmed by concerted agreement on a pricing formula would require an inquiry that courts have long eschewed in antitrust cases—*i.e.*, to "set sail on a sea of doubt" seeking to decide "how much restraint of competition is in the public interest, and how much is not," with the court trying to assess the reasonableness of the prices charged.[28] Also, even if it were demonstrated that the market changes ASIM proposes would in fact produce prices and output at a more optimal level in the immediate short term, they could over time produce unreasonable prices and output, with it being virtually impossible to police the ongoing effects of such concerted use of ASIM's pricing formula.[29]

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[27] *See National Soc'y of Prof. Eng'rs v. United States,* 435 U.S. 679, 688, 692 (1978).

Even if a defense by ASIM premised on the appropriateness of agreed-upon changes of industry pricing structures and output levels were legally cognizable as an efficiency-enhancing device, it is doubtful that ASIM could successfully establish, on the facts, that market performance would improve through its proposed conduct to a closer approximation of optimal market pricing. For example, ASIM's proposal may drive up those prices that are now close to or at a competitive level, while leaving largely undisturbed prices for procedural services that may be reimbursed excessively. It is possible that market forces may be permitting above-optimal prices for procedural services, while keeping the prices of cognitive services at approximately optimal levels.[30] If so, ASIM's efforts could raise cognitive service prices above competitive levels. Thus, if it enhanced reimbursement for cognitive services, concerted adherence to ASIM's proposed RVG could distort the market to a point even further from optimal competitive performance than now exists.

There is certainly no assurance that the price of procedural services will be reduced by the ASIM RVG in the long run. ASIM's efforts to reduce the reimbursement disparity between procedural and cognitive services have reportedly met with concern from representatives of some internal medicine subspecialty groups whose members engage more heavily in procedural services. These groups reportedly do not object to increasing reimbursement for cognitive services, but question a decrease in reimbursement for procedural services.[31] It is very possible that, once consensus on the RVG is reached, use in the market of the relative values accorded different services would result in increases in reimbursement for cognitive services with little or no decrease in reimbursement for procedural services. Moreover, to reach consensus among physician representatives with divergent interests, compromises might result in identification of new cognitive services, not previously billed for, that procedural service oriented physicians can bill to insurers and patients.[32]

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[28] *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 283–84, 291 (6th Cir. 1898), *aff'd as modified*, 175 U.S. 211 (1899). *See also MSMS*, 101 F.T.C. at 293.

[29] *See United States v. Trenton Potteries Co.*, 273 U.S. 392, 397–98 (1927).

[30] Market forces that may be restraining the price of cognitive services to a greater degree than procedural services could include better consumer knowledge of what a "fair" price is for cognitive services; more active or effective consumer involvement in determining whether and when to seek primary care services; a greater proportion of out-of-pocket costs for patients receiving cognitive services because of the terms of insurance coverage; the growth of ambulatory care centers that have extended hours; and growing competition from non-physician health care providers. *See, e.g.*, AMA Council on Med. Service, *Effects of Competition in Medicine*, 249 J. A.M.A. 1864 (Apr. 1983); ASIM, *Reimbursement for Physicians' Cognitive and Procedural Services: A White Paper* 1 (Jan. 1981).

[31] *See, e.g.*, *Am. Med. News*, Oct. 14, 1983, at 14, col. 1.

In addition, ASIM's implicit prediction that physicians would switch to providing more cognitive instead of procedural services and thereby contain health care costs is speculative. Even if some switching did occur, would it be enough to offset any increase in the price of cognitive services so as to lower overall health care costs? Would the resulting output be more beneficial to consumers than the current one? These questions demonstrate the risk inherent in permitting price and output mix to be determined or redirected by private agreement among competitors who have a stake in the outcome.[33]

Finally, the means ASIM plans to use to develop its RVG highlights some of the dangers. ASIM proposes to derive appropriate relative values through a "consensus" building process—polling physicians by means of the Delphi technique. A recent study on the pros and cons of various relative value guide alternatives prepared for the Department of Health and Human Services, noted that if the Delphi technique is used, the representational nature of the polled group is critically important.[34] Physicians "would have a financial stake in the outcome of the RVS determinations and thereby have a substantial conflict of interest if empanelled to determine an RVS."[35] The study explains:

> To the extent that various goals of an RVS would be encouraged as part of a group decision process, e.g., [the goal of] more adequately reward[ing] cognitive services, the process becomes less that of finding a solution and more that of achieving the most politically acceptable choice. The findings of research on formal, group decision-making for problem solving tasks [showing the potential efficacy of such efforts] are unlikely to be valid for group choice tasks in which participants have a stake in the outcome and no objectively correct solution exists. *Id.*

For this and the other foregoing reasons it is not at all clear that concerted use of the ASIM RVG would achieve the cost reductions and beneficial public health policy results ASIM has projected.

Other possible justifications are also unlikely to provide an adequate ground of defense. Widespread adherence to a single RVG could provide a common benchmark for physician pricing. Arguably, this could facilitate enhanced price competition and comparison shopping among physicians by consumers and health plans on the basis of the different conversion factors used by physicians. Some procompetitive benefits of this sort could conceivably result from standard adherence to a single RVG, but it is entirely speculative how substantial those benefits would be and they would likely not outweigh the anticompetitive impact of concerted use of the RVG. Although insurers could possibly have benefitted significantly some years ago from such pricing by physicians, most insurers now have or can obtain computer profiles on physician fees that provide data on pricing differentials among physicians.[36]

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[32] *See supra* p. 12.

[33] *NCAA*, 104 S.Ct. at 2948.

[34] Berenson, *Group Decision-Making Methods*, in *Urban Institute Study*, *supra* note 20, at 123.

[35] *Id.* at 121.

RVGs in some contexts can serve the legitimate, unilateral business needs of third-party payors, promoting competition and efficiency. An RVG adopted for use by an insurer, self-insured employer, health maintenance organization, or the government for its own use as a third-party payor could well be valuable. Here, when a horizontal agreement among physicians to adhere to the ASIM RVG is a realistic possibility, it is also possible that some procompetitive efficiency benefits could be achieved from its unilateral use by individual third-party payors. It is, however, unclear how substantial such benefits would be. More important, if third-party payors have had a critical need for an RVG, it is not clear why private entrepreneurs, research centers, or the payors themselves would not have already satisfied that need, with whatever physician consultation was necessary, short of medical society promulgation of the proposed RVG with its attendant risks.[37]

Finally, informational benefits could flow from the availability of the ASIM RVG for unilateral use by physicians in the marketplace. Such benefits, however, would not be present when physicians conspire to adhere to the RVG, and do not merely use it as an informational tool. Such efficiencies would not, therefore, appear to constitute a valid justification for the unreasonable pricing agreement that is a risk of ASIM's proposal.

The Commission concludes, on balance, that any procompetitive efficiency benefits flowing from ASIM's proposed conduct would not be likely to outweigh the anticompetitive dangers of the agreement to adhere to ASIM's RVG that is a serious risk of its proposal to develop an RVG raising the relative prices of cognitive services.

Alternative Actions to Address the Cognitive/Procedural Disparity

There are actions ASIM can take to further its goal of reducing the alleged reimbursement disparity between cognitive and procedural services that would not appear to raise antitrust problems and that may be helpful to public and private third-party payors. To aid third-party payors in developing sound reimbursement programs and criteria, ASIM has available a range of actions that do not require its incurring antitrust risk through development of a comprehensive

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[36] This information is based upon staff interviews with representatives of large and small insurers and third-party payor administrators.

[37] Commission staff interviews of representatives of insurers generally indicated a lack of enthusiasm for a medical society developed RVG.

RVG and its dissemination to both third-party payors and all its member physicians. For example, ASIM can seek to persuade third-party payors to change their reimbursement methods or amounts without running afoul of the antitrust laws so long as there is no coercive conduct engaged in or threatened, nor any price agreement entered into between ASIM and any third-party payor lessening competition among ASIM's members. ASIM can lobby Congress or the Department of Health and Human Services for changes it desires in physician reimbursement. Expressions of opinion on the policy question of reducing the reimbursement disparity between cognitive and procedural services as would be contained in an ASIM "white paper" do not constitute a restraint of trade and also fall within the ambit of protected free speech. Finally, ASIM can conduct research and analyses that could be used with other information by the Department of Health and Human Services or other third-party payors in constructing an RVG. ASIM could, for example, study, analyze and report on the time, complexity, or costs of specific services performed by internists without developing a formal RVG mechanism and disseminating it to ASIM's member physicians.

Conclusion

The Commission has determined that the danger of an anticompetitive agreement in restraint of trade is sufficiently great that it cannot give approval to ASIM's proposed course of conduct. ASIM can, though, legitimately engage in alternative actions to redress the reimbursement inequities that it perceives. This advisory opinion does not reflect a determination by the Commission that ASIM's proposed conduct would necessarily violate the antitrust laws if undertaken. Nor does it denigrate ASIM's concerns about the public health and cost implications of current third-party payor reimbursement patterns. Rather, the Commission has determined only that advance approval cannot be given for the specific actions ASIM has proposed. This advisory opinion, like all those the Commission issues, is limited to the proposed conduct about which advice has been requested.

By direction of the Commission.

Letter of Request

March 1, 1984

Dear Mr. Muris:

On behalf of our client the American Society of Internal Medicine ("ASIM"), we hereby request an advisory opinion pursuant to 16 C.F.R. §§ 1.1 to 1.4, concerning the development and dissemination of a relative value guide designed to reduce the disparity in reimbursement between cognitive and procedural physician services.

I. *Background*

The American Society of Internal Medicine is the national association of physicians specializing in internal medicine. ASIM believes that current reimbursement policy provides the wrong incentives for utilizing physician services and that these incentives need to be reevaluated. For example, under present insurance payment systems physicians are encouraged, by the high level of reimbursement, to use costly technological and procedural services—EKGs, X-rays and surgical and diagnostic procedures. At the same time, physicians are discouraged, by the low level of reimbursement, from utilizing more time consuming cognitive services—diagnosing patient health problems, providing preventive education, and evaluating lifestyle effects on health.

ASIM believes that the physician reimbursement system should be revalued to increase the relative value of cognitive services and decrease the relative value of procedural services, in order to encourage the use of more personal services and discourage the overuse of procedural services. It is further believed that an increase in the relative amount at which cognitive services are reimbursed, as compared to procedural services, would encourage physicians to spend more time and effort in personalized aspects of care. The increased value of cognitive services should also provide new incentives for more physicians to choose primary care specialities utilizing relatively large amounts of cognitive services.

II. *Activities in Question*

ASIM wishes to promote the concept of changing the physician reimbursement incentives, away from costly technical services and toward less costly personal care services—the cognitive services. In this effort, ASIM will develop and disseminate its evaluation as to how cognitive services can be valued when compared to procedural services to supply an alternative to the current reimbursement system. ASIM will also propose relative value guides for listed medical and surgical services based on factors designed to reduce the discrepancy between cognitive and procedural services.

Initially, ASIM proposes to develop relative value guides only for those cognitive and procedural services provided by physicians who specialize in internal medicine. ASIM intends in the future to work with other physician organizations—including the surgical societies —to develop relative value guides for all listed medical and surgical services, also based on factors designed to reflect relative differences in the cognitive skills and costs required to provide each service.

These relative value guides ("RVG proposal") will contain no conversion factors or pricing information of any kind and will in no way constitute a fee schedule but, instead, will merely list medical services against which relative values will be assigned based on a listed set of relevant factors. As a result, the RVG proposal will merely describe the relative cost and difficulty of certain cognitive services in relation to other services. In this regard, many third party payors agree with the need to reduce the disparity in payment incentive but point to the unavailability of any RVG that accomplishes the desired result.

The development of such a relative value guide for internists' services will necessitate that ASIM consult with various other physician organizations representing the subspecialties of internal medicine (cardiology, gastroenterology, infectious disease, allergy, et al). Each organization will be asked to share with ASIM its assessment of the relative time, complexity, training, and overhead costs involved in each service commonly provided by internists in its subspecialty, and the recommended relative value for each based on these factors. ASIM will then take these recommendations, develop a draft RVG, and attempt to build a consensus among the various internal medicine organizations in support of the new RVG as a valid basis for reducing the disparity between cognitive and procedural services.

The RVG proposal will be developed in a "white paper" which will explain the problems caused by the cognitive-procedural service reimbursement disparity and will provide written examples, by way of relative value guides, as a method to reduce such disparity. The "white paper" will illustrate "how to" use the relative value guides to change the reimbursement structure from the current procedural service basis to a cost of resources basis. The purpose of the "white paper" will be to pursuade and it will itself emphasize its voluntary and advisory nature. It will contain no explicit or implicit threats of any kind against physicians, payors or purchasers. Nor will ASIM issue any such threats in connection with its dissemination or otherwise.

ASIM intends to send the RVG proposal to its members, third party payors, and preferred provider organizations ("PPOs") and request that they consider using the RVG proposal as a guide to develop a reimbursement program consistent with the approach contained in the proposal. ASIM also intends to hold follow up discussions and meetings with interested payors. ASIM will further advise each of its physician members to evaluate the proposal and will recommend that physicians supportive of the concept request a reevaluation of the relative values of physician services in existing or proposed PPO arrangements, and to participate in any such reevaluation. ASIM will not, however, engage in coercive conduct of any kind in this connection, nor will it serve as common agent for any of its members which may be negotiating payments, pricing and reimbursement issues with PPOs, third party payors or purchasers, or other persons or organizations.

Finally, to facilitate the critical discussion of the issues involved and to promote the concept of RVG within the medical profession, ASIM will exchange information regarding the relative value of various services with the American Academy of Family Physicians, the American Academy of Pediatrics or other primary care organizations. However, no price information of any kind will be considered, discussed, or transmitted in any such communication, nor will any explicit or implicit threat or coercive conduct of any kind be undertaken.

III. *Statutory Provision*

The foregoing activities raise questions under Section 1 of the Sherman Act[1] and Section 5 of the Federal Trade Commission Act.[2]

IV. *Present Law*

It is clear that agreements to fix prices or to set fee schedules, or other arrangements which produce anticompetitive effects, violate the antitrust laws. *Arizona v. Maricopa County Medical Society,* 102 S.Ct. 2466 (1982) (*"Maricopa"*).

The Supreme Court has recently determined that an agreement to establish a fee schedule constitutes *per se* price fixing. *See Maricopa.* Although the Federal Trade Commission ("FTC") has not litigated that issue, it has obtained consent orders by which certain professional association agreed to withdraw and to refrain from developing in the future any RVG which also contained conversion factors. *In re California Medical Association,* 93 F.T.C. 519 (1979); *In re Minnesota State Medical Association,* 90 F.T.C. 337 (1977).[3]

Nevertheless, the mere development and circulation of an RVG, without conversion factors, is price neutral and does not necessarily have an anticompetitive purpose or effect. Moreover, activities proposed herein would not involve the implementation of any particular RVG. Indeed individual physicians, third party programs and purchasers of health care all would be explicitly advised to make independent decisions regarding the implementation of any such proposal. Finally, it is significant that the ASIM proposed RVG is designed to reduce total health care costs by creating incentives to substitute low cost care for high cost care. Many of the existing physician reimbursement systems create precisely the opposite incentive.

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[1] 15 U.S.C. 1

[2] 15 U.S.C. 45

[3] Although the complete facts are not known, the FTC has also made agreements and obtained consent orders wherein certain professional society have agreed, among other things, to refrain from developing relative value studies where no mention of conversion factor was made. *In re American College of Radiology,* 89 F.T.C. 144 (1977); *In re American College of Orthopaedic Surgeons,* 88 F.T.C. 968 (1976); *In re American College of Obstetricians and Gynecologists,* 88 F.T.C. 955 (1976).

Judicial precedent has determined that without conversion factors the circulation of relative value guides among association members, individual physicians, component societies, agencies of federal and local government and third party payors, does not violate the antitrust prohibitions against price fixing when the RVG is intended only as suggested methodology for arriving at appropriate fees. *United States v. American Society of Anethesiologist*, 473 F. Supp. 147 (1979). (*"ASA"*). In *ASA* the court found that the publication and circulation of RVG did not amount to an agreement to use the RVG in pricing services and that the circulation of RVG did not curtail competition or interfere with the setting of prices in the marketplace. *Id.*

Indeed, the FTC has recently addressed the issue of whether the mere circulation of even price related information amounted to price fixing and concluded that merely providing information, opinions or advice does not violate Section 5 of the Federal Trade Commission Act ("FTCA"). *In re Michigan State Medical Society*, Dkt No. 9129, 3 Trade Reg. Rep. (CCH) ¶ 21,991 (Feb. 17, 1983). (*"Michigan"*). Although the Commission in *Michigan* determined that the medical society's agreement to fix prices and to boycott third party payors violated Section 5 of the FTCA, the Commission exempted exchanges of information which did not amount to an imposition of a price related agreement. Accordingly, price related communications that do not involve an explicit or implicit agreement or an attempt to reach an agreement were held not to violate Section 5.

The Supreme Court has also recognized that even the mere sharing of price related information does not in itself violate the antitrust laws. *United States v. United States Gypsum Co.*, 428 U.S. 422 (1979). (*"Gypsum"*). In this regard the Court has stated that:

> [t]he exchange of price data and other information among competitors does not invariably have anticompetitive effects; indeed such practices in certain circumstances increase economic efficiency and render markets more, rather than less, competitive.

438 U.S. 422, 440 n. 16 (1978). Thus, the Supreme Court refused to mandate the conclusion that a price fixing violation automatically follows from a finding that the exchange of price information has an impact on prices.

With regard to discussions with third party payors, an association may send information and may express the views of its membership. *Michigan* at 22,469 (where the Commission determined that the order to cease and desist did not reach noncoercive expressions of the medical society's views or the views of its members when made to third parties).[4] Moreover, advocating physician participation in decision making, does not create anticompetitive effects, as long as such advocacy is noncoercive. *Michigan* at 22,470; *Maricopa,* 102 S.Ct. at 2477–78.

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[4] Although binding joint negotiation with third party payors may amount to price fixing, Section 5 does not

(footnote cont'd)

V. *Conclusion*

ASIM believes that its activities with regard to the development and circulation of the RVG proposal will not have a probable or foreseeable anticompetitive effect on physician's fees and should not be precluded by the antitrust laws. *ASA; Michigan* at 22,469. Indeed, we believe that our proposal, if adopted, will be procompetitive and reduce medical care costs. As previously indicated, ASIM's efforts will be purely advisory in nature and are intended only as a suggested methodology to reduce the disparity in relative values between cognitive and procedural physician services. In addition, no conversion factors will be developed, proposed or disseminated so that the proposal is price neutral.

The circulation of the RVG proposal among individual physicians, PPOs and third party payors will not interfere with the PPO's or third party payor's ability to establish whatever pricing strategy they so desire. Moreover, ASIM will not bind nor attempt to bind or coerce its members in any way. Each member will continue to be free to make independent fee decisions.

We will be happy to supply additional information and to discuss this proposal with you in person. We appreciate your prompt attention to this matter.

Respectfully submitted,

/s/ William G. Kopit
Epstein Becker Borsody & Green,
P.C.

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preclude third party payor discussions where each member reserves and exercises independence in pricing decisions. *Virginia Excelsior Mills Inc. v. FTC* ("Virginia") 256 F.2d 538, 541 (where the court noted that the use of a common agent is not illegal when each member reserves and exercises independence in pricing and other material matters). Here, of course, ASIM has stated explicitly that it would not act as a bargaining agent for its members or any other person or organization attempting to implement the RVG.

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